Ethics: An Overview for Texas CPAs

For additional navigational aids, download (save) this document to your computer and view it through Adobe Reader.
Course Information

Course Title: **Ethics: An Overview for Texas CPAs**  #594716

**Recommended CPE credit hours for this course:**
In accordance with the standards of the National Registry of CPE, CPE credits have been granted based on a 50-minute hour.

**CPA: 4**  (Approved by the Texas State Board of Accountancy for the State of Texas CPA Ethics requirement.)

- **Texas State Board of Accountancy Sponsor Number: 009349**
- Beacon Hill Financial Educators is registered with the Texas State Board of Public Accountancy as a CPE sponsor. This registration does not constitute an endorsement by the Board as to the quality of our CPE program.
- National Registry of CPE Sponsors ID Number: 107615.

**Course Description**
The course provides an overview of general ethics and the essential aspects of ethics as they relate to the accounting profession. Topics covered include ethical principles and values, ethical reasoning, ethical dilemmas, and a discussion (with case examples) of the core values of the accounting profession: Integrity, objectivity, and independence.

The course also provides an overview of the Texas Board of Public Accountancy’s Rules of Professional Conduct, which covers how the rules apply to all aspects of professional accounting, whether performed by CPAs in client practice, in industry, in education, or in government. This section also illustrates, using case examples, the enforcement procedures that the Texas State Board of Public Accountancy has undertaken in accordance with the Rules.

**Program Delivery Method:** Self-Study (NASBA QAS Self-Study/interactive)

**Subject Codes/Field of Study**
NASBA (CPA), Regulatory Ethics.

**Course Level, Prerequisites, and Advance Preparation Requirements**
Program Level: Overview.
- This program is appropriate for professionals at all organizational levels.
- Prerequisites: None
- Advance Preparation: None

**Course Content**
Publication/Revision date: 3/15/2016
Author: Colleen Neuharth McClain, CPA
Advance Preparation: None

Instructions for taking this course

You must complete this course within one year of the date of purchase (if you do not complete the course within one year, contact us to determine whether an updated edition of the course is available, in which case we will provide you with a PDF of the updated course and the online exam at no charge).

A passing grade of at least 70% is required on the final exam for this course. You may retake the exam if you do not pass it on the first attempt (no charge).

Complete the course by following the learning objectives listed on the following page, studying the text, and studying the review questions at the end of each major section. Once you have completed studying the course and you are confident that the learning objectives have been met, answer the final exam questions (online).

Instructions for Taking the Final Exam Online

• Login to your account online at www.bhfe.com.
• Go to “My Account” and view your course.
• Select “Take Exam” for this course and follow instructions.

Additional Information

• The exam may be started, stopped, then resumed at a later date.
• The exam is "open book," it is not timed, and it may be retaken if not passed on the first attempt (no charge).
• Results (correct, incorrect answers) and certificate appear immediately upon passing the exam.

Have a question? Call us at 800-588-7039 or email us at contact@bhfe.com.
Learning Objectives

After completing this course, you should be able to

- Recognize the purpose of studying ethics and the tools that can be used to improve your ethical reasoning abilities.
- Recognize the process of ethical reasoning and how to apply it when faced with specific dilemmas.
- Define the core values of the CPA profession (integrity, objectivity, and independence).
- Recognize the Texas Rules of Professional Conduct and enforcement actions that the Board has recently taken to apply those rules.
# Table of Contents

## Course Information

- Part I. Overview of Ethics in the Accounting Profession
  - Defining Ethics
  - Ethical Principles and Values
  - Ethics and the Certified Public Accountant
    - Case Study: Effectiveness of Accounting Ethics Courses
  - Ethical Reasoning and Ethical Dilemmas
    - Utilitarianism
    - Deontology
    - Ethical Reasoning
      - The Reasoning Process
      - Case Study: Ethical Reasoning
    - Ethical Dilemmas
      - Ethical Dilemma: Greed
      - Case Study: Greed Can Get the Best Of You
      - Ethical Dilemma: Need to Succeed
      - Case Study: Climbing the Corporate Ladder—David G. Friehling
  - Integrity, Objectivity, and Independence: Core Values of the Profession
    - Case Study: Effectiveness of Accounting Ethics Courses
    - Texas Rule §501.73: Integrity and Objectivity
    - Case Study: TSBPA Enforcement Action
    - Case Study: The Reporting Dilemma
  - Independence
    - Risk-Based Approach to Independence
      - Steps Required Under the Risk-Based Approach to Independence
    - Definitions Related to Independence
    - Categories of Threats to Independence
    - Categories of Safeguards for Independence
    - Case Study - Performance of Nonattest Services (Interpretation 101-3)
  - Part I Review

## Part II. Texas Rules of Professional Conduct

- History of the Texas Rules of Professional Conduct
- Applying the Rules of Professional Conduct
- Professional Standards
  - Case Study: Attestation Engagement
  - Responsibilities to Clients
    - Board Ruling: Testifying as an Expert and Contingent Fees
  - Integrity and Objectivity in the Performance of Accounting Services
    - Case Study: Integrity and Objectivity
  - Competence in the Performance of Professional Services
    - Case Study: Competence
  - Disposition of Records and Work Papers
    - Case Study: Competence, Discreditable Acts
  - Withdrawal or Resignation from an Engagement
    - Case Study: Competence, Discreditable Acts
  - License to Practice in Public Accountancy
    - Case Study: Practice of Public Accountancy, Firm License Requirements

- Table of Contents
- Learning Objectives
- Course Information
- Part I. Overview of Ethics in the Accounting Profession
- Part II. Texas Rules of Professional Conduct
Part I. Overview of Ethics in the Accounting Profession

Defining Ethics

1. Ethics (also known as moral philosophy) can be defined as “a branch of philosophy that addresses questions about morality—that is, concepts such as good and evil, right and wrong, virtue and vice, and justice.”

The following are the major sub-branches of ethical study:

- **Meta-ethics:** The theoretical meaning and reference of moral propositions and how their truth-values (if any) may be determined;
- **Normative ethics:** The practical means of determining a moral course of action;
- **Applied ethics:** How moral outcomes can be achieved in specific situations;
- **Moral psychology:** How moral capacity or moral agency develops and what its nature is; and
- **Descriptive ethics:** What moral values people actually abide by.”

2. Ethics can also be defined as

- The science of human duty and the body of rules of duty drawn from this science;
- A particular system of principles and rules concerning duty;
- Rules of practice in respect to a single class of human action, such as political, social, or medical ethics.

While the definition in #1 offers a look at ethics as a philosophy, the second definition refers to ethics more in terms of a set of rules and principles.

The term ethics can be defined in many ways. In the context of this course, we will use the term “ethics” to mean a set of rules based on an individual’s or specific group’s principles and values.

Ethical Principles and Values

Our ethical principles and values are the guides to our ethical decision making, as they provide direction for our reasoning when we are faced with an ethical dilemma. For example, if a person truly values people and believes in the principle that all people should be treated equally, he or she would most likely not be compelled to make any decisions based on racism.

The following are some examples of ethical principles:

- **Autonomy** – Individuals should be allowed to make their own decisions based on what is important to their lives.
- **Beneficence** – The duty to do good both individually and for all. This principle is mainly associated with the utilitarian ethical theory, which will be discussed later in the course.
- **Confidentiality** – The duty to respect privacy of information and action.
- **Finality** – The duty to take action that may override the demands of law, religion, and social customs.
- **Justice** – All people should be treated fairly.
Least harm – People should base their decisions on doing the least amount of harm to the fewest number of people.

No Harm – Unlike the principle of Least Harm, No Harm is the duty to cause no harm, to individuals or to the masses.

Publicity – The duty to take actions based on ethical standards that must be known and recognized by all who are involved.

Respect for persons – Individuals should honor others, their rights, and their responsibilities in the same way that they honor themselves.

Understanding/Tolerance – Individuals should appreciate and accept other people’s viewpoints, if reason dictates that doing so is warranted.

Veracity – Individuals should always be honest and tell the truth.

While it is a good idea for an individual to create his or her own principles and value system, it should also be recognized that there will be principles and a value system held by the group or profession to which that individual may belong. For example, upon becoming a CPA in the state of Texas, each applicant is required to take an oath of office to support the laws and the Constitution of the United States, the laws of Texas, and the rules adopted by the Texas State Board of Public Accountancy.

Ethics and the Certified Public Accountant

The first professional accountants were known to have originated in England during the late 1800’s. However, the title of Certified Public Accountant (CPA) was first created when, in 1896, the state of New York passed a law designating the professional status of accountants. By doing so, New York also set the path for the process of regulating the accounting profession at the state level rather than at the federal level.

Today, all states in the U.S. have passed laws governing the accounting profession. In addition, all U.S. state legislatures, regulate the administration of the CPA examination and licensing for the accounting profession. These regulations include the requirements for continued professional education (CPE) for CPAs.

Ethics in accounting is believed to have been introduced by Luca Pacioli (the “Father of Accounting”), then later expanded by government groups, professional organizations, and independent companies. Michael J. Fischer, in his paper “Luca Pacioli on Business Profits,” concludes that “it appears almost certain that he [Pacioli] would not tell us that there was anything fundamentally wrong or undesirable about engaging in business activities, nor the pursuit of profits. In fact, Pacioli indicated his belief that the profit motive is a critical element of the successful business.

However, it also appears that Pacioli would strongly advise us to conduct our business both honestly and, perhaps more importantly, with a constant eye toward our conduct as business people. Further, Pacioli clearly did not suggest that businesspersons should somehow separate their business from their personal lives. Quite the contrary, he indicated that successful businesspeople should see the secular and spiritual aspects of their lives as inextricably intertwined, and reflect that in the conduct of their business affairs.”

2 Geijsbeek, 1914, pp. 37–38; Brown and Johnston, 1963, p. 34; Cripps, 1995, p. 9
Subsequent to the collapse of Enron and Andersen LLP, the Texas State Board of Public Accountancy (TSBPA) decided that two hours of board-approved ethics continuing professional education (CPE) every three years was not sufficient. Beginning January 1, 2005, every licensee was required to take a four-hour ethics course on the Board’s Rules of Professional Conduct every two years.

All but six states now require ethics training for CPAs. While most if not all CPAs agree that a CPA should achieve and maintain the highest standards of ethical conduct, there has been much controversy as to the effectiveness of ethics training in accomplishing this goal.

Can you actually teach someone to starve before they would steal food? Most believe that, being educated in ethics cannot completely eliminate unethical acts, it can greatly reduce the probability of them occurring.

The technical training we receive as CPAs does not eliminate the possibility that we will err in the way we choose to account for a particular transaction but it significantly reduces the probability. Likewise, ethics training will not eliminate the possibility that we will exercise poor judgment in a particular situation, but it will greatly reduce that probability also.

**Case Study: Effectiveness of Accounting Ethics Courses**

In 1993, Mary Beth Armstrong completed a study (Mary Beth Armstrong, “Ethics and Professionalism in Accounting Education: A Sample Course,” Journal of Accounting Education, 1993), in which she provided data demonstrating that an accounting ethics course can increase a participant’s ethical sensitivity.

Armstrong tested students at the beginning and the end of the semester, using Rest’s Defining Issues Test. Her data indicated that those students who had already taken a general ethics course and who also took an ethics and professionalism course scored significantly higher on Rest’s Defining Issues Test than those who had not taken any ethics course. An increase in one’s ethical sensitivity is thus the result of a synergy of academic experiences in ethics, she concluded.

Rest’s Defining Issues Test (DIT), developed by James Rest in 1979, is designed to assess a person’s stage of moral development. The stages used are based on Kohlberg's approach to morality, which places individuals into one of the following six stages of moral development:

- **Stage 1:** The morality of obedience: Do what you're told.
- **Stage 2:** The morality of instrumental egoism and simple exchange: Let's make a deal.
- **Stage 3:** The morality of interpersonal concordance: Be considerate, nice, and kind: you'll make friends.
- **Stage 4:** The morality of law and duty to the social order: Everyone in society is obligated to and protected by the law.
- **Stage 5:** The morality of consensus-building procedures: You are obligated by the arrangements that are agreed to by due process procedures.
- **Stage 6:** The morality of non-arbitrary social cooperation: Morality is defined by how rational and impartial people would ideally organize cooperation.

3 (Rest, & Narvaez, 1994, p. 5)
Seven Goals of Accounting Ethics Education

- Relate accounting education to moral issues.
- Recognize issues in accounting that have ethical implications.
- Develop "a sense of moral obligation" or responsibility.
- Develop the abilities needed to deal with ethical conflicts or dilemmas.
- Learn to deal with the uncertainties of the accounting profession.
- "Set the stage for" a change in ethical behavior.
- Appreciate and understand the history and composition of all aspects of accounting ethics and their relationship to the general field of ethics. —Stephen E. Loeb

Ethical Reasoning and Ethical Dilemmas

There are basically two philosophies that are most frequently used by CPAs to resolve ethical dilemmas: Utilitarianism and Deontology.

Utilitarianism

Utilitarianism holds that “actions are right to the degree that they tend to promote the greatest good for the greatest number.” Utilitarians look to consequences of acts for moral justification. The goal is to maximize the overall good. For example, accountants are “being utilitarian” when they conduct a cost/benefit analysis. The probable cost of taking a particular course of action is weighed against the probable benefits to be derived. This task becomes more difficult, however, if an accountant is unable to measure a benefit in terms of dollars, such as one associated with social responsibility accounting. This illustrates one of the problems with utilitarianism: the potential benefit of an action may not be easily defined (or quantified).

Deontology

In contrast to utilitarianism, deontology theory emphasizes the importance of not only the consequences of actions but also the features of the act itself. Deontologists emphasize that morals are based on maxims, rules, and principles, not merely on results.

According to Cheffers and Pakaluk in their book Understanding Accounting Ethics: “For deontology, the crucial question to ask when contemplating the morality of an action is, ‘What if everybody did this?’ If you cannot wish that everyone else do the same thing in similar circumstances—that is, if you want to treat your own conduct as an exception—then that action is morally excluded.”

---

4 Stephen E. Loeb, 1988, "Teaching Students Accounting Ethics: Some Crucial Issues"
this theory, an accountant is morally bound to act according to the requirements of an established rule of conduct without regard to a concern for the effects of that action.\(^8\)

**Ethical Reasoning**

Largely due to the recent corporate scandals at Enron, WorldCom, and Arthur Anderson involving senior management and CFOs manipulating the books to make their companies appear more profitable, considerable research has been done to investigate the ethical reasoning and dilemmas that CPAs face on a regular basis. Prior to these events, research focused more on accountants’ adherence to rules of professional conduct than on theoretical issues such as the difference between right and wrong.

The often intense pressure experienced by CPAs, especially at the organizational level, requires a greater sensitivity of the fundamentals of ethical reasoning and decision making. While we understand that CPAs should not allow these pressures to violate their ethical, legal, and moral standards; it is true that the ethical dilemmas that can grow out of an increasingly complex professional work environment require a greater ability to grapple with dilemmas that are often characterized by gray areas and the lack of a clear road map as to how to proceed.

**The Reasoning Process**

When resolving ethical dilemmas, Iris Stuart developed an ethics model for the accounting profession consisting of four steps:

1. The accountant must recognize that an ethical dilemma is occurring.
2. The accountant must identify the parties that would be interested in the outcome of the dilemma.
3. The accountant must determine alternatives and evaluate the effect of each alternative on the interested parties.
4. The accountant must select the best alternative.\(^9\)

**Case Study: Ethical Reasoning**

A study was published in 1994 to determine how one hundred randomly selected auditors used ethical reasoning when confronted with issues related to AICPA rule regarding client confidentiality (ET Section 1.700.001), *Confidential Client Information* of the AICPA’ Code of Professional Conduct)\(^10\).

Review the scenarios that the auditors were provided with and respond to each circumstance using the following guide (as originally provided in the study):

1. To inform or not inform a third party of confidential client information,
2. Indicate which response given in #1 is considered "good ethical behavior" if the Code was disregarded, and

---

Scenario 1

James Corporation employs the regional CPA firm of Green and Cash to audit its financial statements. The firm has been asked to prepare quarterly financial statements for the first quarter of 1986. Bob Ethics, a staff accountant, was assigned to do the work. During the course of preparing the statements, Bob discovered that James Corporation materially understated net income on last year's tax return. Bob informed his supervisor about this and the client was asked to prepare an amended tax return. The client, however, refused to take corrective action.

What would you do? Why?

After tallying the results for scenario 1, the study concluded that “given a Code, most (78%) respondents would not inform the IRS. This is in agreement with the Rules of Conduct. Although the variability increased, most CPAs (70%) in this situation would make the same decision without a Code. This is consistent with the justification given that most CPAs perceived themselves to be an advocate of the client in a tax engagement. There was no perceived conflict in the Rules of Conduct, and what most accountants consider to be good ethical behavior.”

Scenario 2

Johnson Manufacturing Corporation is a publicly owned company that manufactures equipment used by hospitals and medical laboratories. The company is audited by the national accounting firm of Adams & Pitre. One day, John, who was in charge of the engagement, overheard a conversation between two managers indicating that although they met inspection standards, they were aware of a defect in a particular piece of equipment, but they had not notified any of their customers because they felt the probability of a malfunction was low. John took this information to the controller and was told not to include it in the audit report. John then took the information to the manager on the engagement. The manager informed University Hospital, a client and also a major customer of Johnson Manufacturing Corporation, not to purchase any more equipment from Johnson. Johnson sues Adams & Pitre for violating the confidentiality rule.

What would you do? Why?

After tallying the responses to Scenario 2, the study found that “most CPAs (78%) responding to this situation would adhere to the Code and not inform one client of information discovered while auditing another client. A large percentage (52%) of respondents, however, indicated that informing the client would be the "best ethical behavior." In most instances, "potential safety concerns" were cited as the justification for considering informing as the "best ethical behavior." Thus, there appears to be some conflict between adhering to the Code and the underlying moral values of some CPAs.”
Scenario 3

William Johnson, a CPA, served as a director of Last National Bank for a year. As a director, William may be held liable for damages if he fails to use care and prudence in administering bank affairs and such action causes the bank to suffer a financial loss. In the course of an audit, William discovered a seriously weakened financial position of a client who has a large loan from Last National Bank. Disclosure of this condition to the other bank directors would help to minimize the bank's loss, however, since the audit has not been completed, this would represent a violation of Rule 301 of the Code.

What would you do? Why?

From the responses to Scenario 3 that were received in the study, it was determined that “given a Code, a majority (78%) of CPAs would not inform, which is in agreement with the Code. A lesser percentage (53%), however, feel this is the best ethical behavior.”

In conclusion, the study summarized the following:

“The findings of this study indicate that CPAs usually adhere to the Code (and the theory of Deontology) in resolving issues involving confidentiality. However, such decisions are not always in accord with what they perceive as "good ethical behavior." The broad principles of the Code indicate that ethical conduct, in the truest sense, means more than abiding by a letter of a rule. It means accepting a responsibility to do what is honorable or do that which promotes the greatest good to the greatest number of people, even if it results in some personal sacrifice. Somehow, the profession needs to emphasize the "greatest good" criterion more strongly in applying the Rules of Conduct.”

Ethical Dilemmas

*Ethical Dilemma: Greed*

One of the most common reasons CPAs compromise their ethical values is due to greed. Greed, an excessive desire to possess wealth or goods, can be so overpowering that many times it so overwhelms us that we do things we know are wrong. Most individuals who are driven by greed seem to somehow find a way to justify their actions, in a way that convinces them that what they are doing is not really unethical.

The following case study is an abbreviated version of what happened to one corporate executive (who chooses to remain anonymous). In his own words, the once successful executive describes how he let greed interfere with his otherwise moralistic manner of doing business. It is his hope that, by sharing this story, he will be able to help others avoid the pitfalls that he encountered.
Case Study: Greed Can Get the Best Of You

How It All Began
It had been six years into a very prosperous career in the financial services industry and one year into my tenure with a new company. Then it all began one winter night as I drove home from a long day at work. Back then, I was going through some minor financial hardship. I basically had an outstanding debt of approximately $6,000, which had been weighing heavily on my finances. The year before, my father passed away and I had to support my mother financially. In so doing, I racked up some debt to pay for her living expenses until things came back to normal. I also racked up some sense of frustration over my inability to be financially capable and manage to support my family with more ease. Of note, my salary then was already in the range of $60K a year, a figure that could’ve been enough to get me through my debts in due time, but for various reasons, I just couldn’t manage on.

As part of my job, I was solely responsible for managing the relationship with several vendors and had discretion over handling invoices and payments to them. These expenses ran in the range of $50-$80K a year. Specifically there were two vendors, which as I will explain, both became components of my scheme, without their knowledge that is. Let’s call them vendor A and vendor B. Vendor A was responsible for providing research tools and analysis. Vendor B provided all the technology support for vendor A, but I paid them both directly.

Towards the end of the year, vendor B, the technology provider, withdrew from the contract because I had objected to their dramatic raising of fees. Following their departure, and under pressure from me (with no malicious intentions), vendor A hired a technology consultant on a full time basis, who was tasked with providing the same services that the old vendor provided. This new arrangement translated into savings of tens of thousands of dollars, as the cost of hiring that consultant was much smaller than paying the old vendor for virtually the same services. Also worth mentioning, the departure of the old vendor and the delegation of their technology support services to the remaining vendor did not become known to my superiors. It just so happened that the new arrangement transpired very quickly.

So back to that one night when I was driving home from the office: In the weeks before I had received notices regarding my outstanding debts and I was stressing about it. So sitting in traffic, listening to the radio, I had the first glimpse of an idea: Since I saved a lot of money with this new vendor arrangement, what if I could utilize some of those savings; kind of give myself a bonus, to help me get out of debt.

I thought to myself that this would be just an isolated act that did not represent who I was as a person. I justified to myself that tapping into those supposed savings of a few thousand dollars would hardly impact the company financially, given its colossal annual revenues of over a hundred million dollars. I told myself that it would only amount to rewarding myself for my successful negotiations, which had led to the drastic reduction in the cost of vendor services. Most notably, I convinced myself that this would be an exceptional one-time transaction, not a continuous scheme, and was by no means an act of fraud.

Lying To the Mirror
If there’s one phase of fraud’s psychological continuum you need to watch out for, this beginning phase is it! It’s that point before you actually cross the line, but when you begin rationalizing why crossing the line is justified. For me that very moment was on that winter night when I rationalized to myself that stealing money from my employer was not theft but rather a business transaction. Sure enough, almost every embezzlement offense I’ve read about had traces of that same dynamic: the
offender rationalizing that his action was justified, or that it didn’t represent who they are or that it was something less deplorable than what it really was - fraud!

As you’re reading this, and if you’re encountering a similar situation, I recommend that you take an honest look at any wrong actions you’ve taken or are about to take. Most likely that corrupt choice was justified by a giddy rationale, which conveniently made your self-serving behavior seem acceptable. Believe me, once you cross that line, turning back just gets harder and harder. You have to remember that in my case and prior to that date, I had never done anything remotely close to this.

So if you’re thinking to yourself, “the fraud I’m committing does not represent who I am. Really I’m not that kind of a person…,” well you better think again. You know the old adage, “stupid is as stupid does”? Well the moment you commit a crime, you ARE a criminal, regardless of whether it’s your first offense. Further, believing that you are a decent person — and you may be indeed — does not give you impunity from doing indecent things. Who we are is more a reflection of what we do than who we believe we are.

Sure enough, I considered myself a decent person. I truly did. I based this self-assessment on my dignified views of people and of the world, which lacked rancor or envy. I based it on my lifelong encounters with family, friends and teachers, to whom I always showed respect and tenderness. I based it on the various points of my history where I often opted to do the right thing at the expense of giving up something in return.

But the moment I committed fraud is the moment I ceased to be a decent person. What I did is what mattered; not who I thought I was. Ask yourself this simple question: Is what I’m doing illegal? The answer should be a simple yes or no. No explanation of how decent you [otherwise] are should matter.

**Fraud Triangle**

I did not linger at the question. I slipped right through it with my faulty reasoning, fueled by a need for money. I worked out my plan as follows: I would establish a new corporation that bore a similar name to vendor B, who no longer provided us services but their departure was unknown to my superiors. Using fictitious invoices that looked exactly like the ones vendor B used to send us, I would create invoices for work that was no longer done by that vendor but that was being provided by the other vendor, who I legitimately paid separately. I would submit those invoices to Accounting and would request to pick up the checks personally under the excuse that I needed to overnight them myself to ensure proper delivery. I would then deposit the checks into a bank account that I would establish for that new shell company.

Once I paid off the debt, I would stop. Further, I vowed to myself that as soon as my financial situation improved, I would pay back the money by making a direct payment to the remaining vendor out of my pocket in the same amount that I tapped into.

Once again I point to the conniving nature of “rationalization,” which is the cornerstone of all embezzlement offenses. Criminologists call it the Fraud Triangle: Existence of Pressure (financial need) and presence of Opportunity (money,) followed by Rationalization that the wrong behavior is justified by valid reasons. For the weak of will, these factors combined could give birth to fraud, especially in the absence of a strong moral code. And in my case, they did.
No Turning Back

So it was, I established a corporation that bore a similar name to vendor B. I then opened a bank account for that corporation. I turned in my first invoice for the amount of $8,500 using the template from the original vendor that was emailed to me. I requested it that accounting provides me the check personally. I picked up the check and deposited into the bank, where I had been a regular client, and the slight difference between the name of on my account and the name to whom the check was payable went unnoticed. The first transaction went smoothly. I transferred the money from my business account to my personal account and paid off the debt in its entirety. I planned to close the business account the next day and dissolve the shell company.

The next day. I was very busy with work and I just decided to put off closing the account and dissolving the shell company for another week or so. A week later I still had not done it. A month later I still had not got it done. A couple of months later I needed money again and I repeated the invoicing process, albeit for a much smaller amount. After that, I just couldn’t stop. Over the course of two years, I had generated over a dozen invoices and received an equal number of checks for what eventually amounted to nearly one hundred thousand dollars.

So how did I make the leap from a one-time transaction to an ongoing process? As pitiful as any explanation may sound, the merits of the additional income simply blinded me. The monetary reward made my initial flawed justification all the more believable: I wasn’t committing fraud; I was just tapping into the savings that I managed to yield! The depths of my action (betraying my employer) and the possible repercussions (legal and professional) all languished in the background, overshadowed by the handsome financial rewards and suppressed by the seemingly acceptable rationalization (I wasn’t hurting the company financially!)

Intentions Don’t Count

Criminologists describe another dynamic in the mindset of the embezzler, something called “wages in kind.” This occurs when the embezzler believes he’s entitled to the assets he’s stealing. There’s the famous tale about the bookkeeper who was denied a $100 monthly raise. Over the next 10 years, he embezzled a total of $12,000 in the form of $100 a month of fraudulent payments to himself, the same raise amount he had asked for!

In my case, I did not have any such entitlement claims. On the contrary, during the couple of years following the beginning of the scheme, my prominence in the company was rising exponentially. I had built a name for myself in the industry as a research analyst and generated a lot of publicity for the company through my various research papers. I won employee recognition awards, I was allowed to hire more staff and I basically had a very rewarding job in more ways than one. In all honesty, I truly was passionate about the company and my work, and was known around the company for my uplifting demeanor and my positive attitude. I sincerely cared about the success and future of the company.

Paradoxically, having this genuine heartfelt admiration for the organization made me all the less guilt-ridden about what I did behind their back. It somehow alleviated the awfulness of my actions.

Equally delusional, I convinced myself at the time that cheating on the company was not necessarily deplorable, since I truly cared for them! But now that I look back at those years, I realize that I did hold some of those unfounded “wage in kind” views. To the extent that I believed I was making a lot of money for the company and truly cared for their well being, I rationalized that diverting some additional income to myself was not entirely unconscionable. Oh how we fool ourselves!
As you’ve read this, and if you encounter a similar situation, once again I ask you to honestly examine the nature of your action. If you believe you’re entitled to some additional privilege from your employer, that’s understandable. But know this: when in the midst of fraud, one often looks for and finds easy ways to justify his actions. With me, it started with the rationale that I was capitalizing on some savings I had earned for the company. Then I rationalized that the company’s financial state was so strong that my theft would not impact it. Then I believed that my genuine passion for the company neutralized the fact that I stole from them. The point is that you’ll never run out of frivolous reasons to justify your actions. What I advise you to do is to admit to yourself that no one reason justifies stealing from your employer (or anyone else for that matter.) If that’s not enough to stop you, then think of the hefty price you’ll pay in the end compared to the forgone privileges to which you believe you’re entitled. For me, I’m going to prison very soon; a hefty price indeed!

Above all, remember that your biggest enemy is yourself. Look at the outrageous excuses I used to justify my behavior (I made them money and so a little theft is okay!) I think I just wanted to believe any excuses, as senseless as they were, so that I could subside the guilt I was feeling. And this was my biggest lie: I believed that I believed my lies! The truth is, in all of this, the person I deceived the most was not my employer; it was me.

**Fear subsided**

Now you have to wonder though: guilt aside, do embezzlers fear getting caught? Did I? Would you? For me, the answer is yes, I did, well at least in the beginning. But with time, this act seeped into my life that it became simply an accepted fact of my existence. I was so blinded to reality by the hypnotizing effect of money that I completely discarded any attempts to confront the fearful repercussions of my actions. As idiotic as it may sound, I got to a point where I almost forgot about the scheme, I just did it! Do I sound fearless to you? Think again. It wasn’t the lack of fear that blinded me; it was the greed, the money, and most of all, the denial. I avoided facing reality by digging my head in the sand pretending that if I didn’t see the problem it would just cease to exist.

There’s a famous fraud story about this CFO who had sole control over the accounting systems at a mid-size bank. One day he tapped into some funds in one account and managed to conceal it by making fake reverse entries in another account. He did this for a few years completely undetected and amassed over $150,000 in illegal funds. Then one day, a customer made a double payment to the bank. The redundant check was forwarded to the CFO for processing. After the check sat at his desk untouched for a week, the CFO finally took the check, endorsed it to himself and deposited it directly into his account! When the customer got the returned check and realized the foul play, he called the company and eventually an outside audit uncovered the entire scheme.

So why do you think the CFO went as far as to make such an incriminating move signing his own name on a client’s check? Was he fearless? Absolutely not! Like me, his greed grew over time to the point that he became incapable of reasoning. Hardly an excuse for his illegal actions, or mine for that matter, but the point I’m driving home is that after a while, you’re bound to lose sight of reality. If you thought it was hard to control your actions in the initial stages, wait until you get farther along. Greed overpowers fear, especially when you grow accustomed to the financial rewards. So be wary, if you’re already in the midst of committing fraud, it’s NOT too late to stop. If you use the rationale of “I’m too far along in this mess to stop now,” you’re wrong. It will only get worse from here, both in legal terms and in the sense of your ability to stop. And if you think your lack of fear is a sign of your infallibility, you’re wrong again. The absence
of anxiety is rather a sign that you’re so enmeshed in your foolish behavior that its severity doesn’t faze you anymore. Sooner or later, your foolish behavior will catch up to you, as it did to me.

**Reality Hits**

Nearly two years into my scheme, someone in accounting noticed a discrepancy in two of the fictitious invoices I had submitted. In less than two days, a simple audit managed to uncover the entire scheme. One Monday morning in the office, I was confronted with the findings and I admitted my crime and provided full details about the nature of the scheme. I was fired on the spot and was told to expect legal action against me. Here’s the horrifying part, and I’m being truthful when I tell you this: When they confronted me about the scheme, and for a split second, I couldn’t tell if I had truly done this or if I had just once thought about doing it! I know it sounds silly, perhaps even pathetic. But this is another of greed’s many tricks: it gives birth to other traits. In my case, one of those traits was none other than “denial.” So it was that when I got into my car and drove home, I had only one thought in mind: Suicide. I couldn’t face what I had done. I couldn’t face what awaited me!

When denial is reversed, all you’re left with is a big shock. And in my shock, I could think of no other way to avoid the shame awaiting me except by not being there to face it. Worse yet, I just couldn’t stand myself; I resented every last breath of my existence. In a way, I really wanted to punish myself!

To spare you the morbid details, my suicide attempt was not successful. I slit my wrists multiple times and swallowed 90 pills of a sleeping aid, but ended up losing consciousness for 36 hours and losing little blood. When I woke up in a daze, not sure if I were dead or alive, I immediately called my fiancé and my brother, who came to my aid. I only lived because I missed the veins.

After recovering from that initial shock, I came to my senses and realized what had really happened. I retained the services of an attorney and attempted to reach a civil compromise where I’d pay back the money, which I had already spent over the course of two years.

The more I regained sight of reality, the more I realized how bleak that reality was. But I knew that despite whatever state of denial I was under in the past two years, my actions were real and I had to take responsibility for them. I waited, and two weeks later, I was arrested at my home.

**The Aftermath**

I’m now out on bail, awaiting my sentencing. I expect to begin my incarceration very soon. Due to the nature of my role, I have also been barred from the securities industry for life. Predictably, I’m liable for all the funds I embezzled and will be ordered to pay them in full (I already voluntarily began paying back some of the money with the help of my family.) In addition, the legal fees I’ve incurred in the process already amount to nearly what I stole. But this is nothing compared to the intangible damage I’ve caused. The news of the whole incident was made public and virtually everyone who had any association with my employer, my colleagues included, became fully aware of the whole ordeal. Shame and a tarnished reputation will haunt me forever. In committing my act, I have betrayed so many people who trusted me; a breach of trust of which I’m reminded every other day in my nightmares. I’ve disappointed those who believed in me, and gave them reasons not to ever believe again. Worse yet, I’ve disappointed my family, especially my mother, who despite the support she gave me during my crisis, her disappointed eyes can’t help but tell the truth.

You know, some mistakes are reversible and some damage is repairable. But with tales of betrayal, much like the cheating boyfriend story I mentioned earlier, there is little you can do to alleviate the harm you caused to others and to yourself, especially the legal consequences. All that’s left to do is to
turn this saga into an experience that makes a better person out of you, not a worse one. But believe me, you’re much better off not having to go through it in the first place.

**The Right Choice**

So in my final words to you, I’ll say this: laws exist not just because someone imposed them upon us; they exist because they’re right! They validate human concepts, which even without the existence of [those laws], are still sensible. Stealing money that doesn’t belong to you is the wrong thing to do, even if law didn’t prohibit it.

But there IS a law that prohibits it, and when you break that law, there are dreadful repercussions waiting for you. Those repercussions, including going to jail, are life-altering and their damage will haunt you for the rest of your life. The ramifications of your actions will not only affect you but will also hurt your family and loved ones. Greed and denial will make you lose sight of those consequences or even ignore them. Don’t let them blind you. Instead, do the right thing: Stop the fraud now or just don’t start it. You have the choice. Believe me, I’d do anything to go back in time and make that right choice. But I can’t, so instead, I hope to help others do so.

I wish you the best of luck doing the right thing and staying out of trouble!

**Follow up questions asked by the interviewer:**

**Question:** What, if anything, could those around you done to prevent you from embezzling the funds?

Answer: I think if someone were to bring to my attention a similar story like the one I’m now sharing with the public, it would have likely brought me to my senses and made me see what I was doing for what it REALLY was. One of the problems is that embezzlers often unconsciously alter their perception of reality in a way that effectively subsides their guilt and quells their fear. But a reality check in the form of hearing or reading about someone else's horrid tale is bound to bring them out of that self-induced hypnosis and make them stop. Further, I think it has an even higher chance of deterring them from embarking on the fraud in the first place.

**Question:** If you hadn't been caught, do you think you would have stopped by yourself?

Answer: Yes, I think I would have.

**Question:** Without implicating anyone else, did you tell anyone and if so, what was their reaction?

Answer: No, nor did I feel the urge to. I used to tell friends that I do some consulting on the side; and after a while I sort of believed I did!

**Question:** Did the idea of “getting away with it” excite you or was it all for the money?

Answer: I never thought about getting caught. My view of the whole situation conveniently ended at the part where money entered my bank account. But I can tell you for sure that I did not get any kicks out of doing it either. I loathed turning in the fake invoices and dreaded even more going to bank to deposit the checks. My research on the topic, however, tells me that some people do enjoy the "drill." I wasn't one of them.

**Question:** If you were to start your own company, what would be the most important types of controls that you would put into place to prevent someone from embezzling from you?
Ethical Dilemma: Need to Succeed

Often unethical behavior is driven by the need to succeed. But, how do you measure success? Whether it be “climbing the corporate ladder” or “adding another zero,” to our salary, how much fame or fortune does a person really need in order to feel successful?

Case Study: Climbing the Corporate Ladder—David G. Friehling

On March 10, 2009, a Criminal Information was filed in Manhattan federal court charging Bernard L. Madoff with eleven felony charges including securities fraud, investment adviser fraud, mail fraud, wire fraud, three counts of money laundering, false statements, perjury, false filings with the United States Securities and Exchange Commission (SEC), and theft from an employee benefit plan. There was no plea agreement between the Government and the defendant. On March 12, 2009, Madoff pleaded guilty to all eleven charges. On June 29, 2009, Madoff was sentenced to a term of imprisonment of 150 years.

David G. Friehling, the CPA who performed audit services for Madoff, pleaded guilty November 3, 2009 to nine criminal charges carrying a potential prison term of 114 years. Among the charges are securities fraud, investment advisor fraud, making false filings with the SEC and obstructing or impeding the administration of the Internal Revenue Office (IRS). At 49 years old, with a wife and three children, Friehling’s career as a CPA is over.

According to court documents, from 1991 through 2009, Friehling worked as a sole proprietor at the firm Friehling and Horowitz, CPAs. Jerome Horowitz (Friehling’s father-in-law) is reported to have retired in 1991, and Friehling has been the only employee of the firm since that time.

For 17 years, Friehling was retained by Madoff Investment Securities to audit its financial statements, which were filed with the SEC. In court, Friehling stated that his father-in-law, Jerome Horowitz, prior to retiring, was the auditor for Madoff Investment Securities. Horowitz also occasionally assisted Friehling, according to his testimony, in conducting the audit for Madoff Investment Securities after he retired and until 1998. Horowitz passed away from cancer, on March 12th 2009, on the day Madoff pleaded guilty.

Although he received a monthly retainer throughout the 17 years, the courts found that Friehling never once actually performed a meaningful audit of Madoff Investment Securities (i.e., he did not verify any of the information provided to him by Madoff). Yet, over the 17 years, he issued numerous reports stating that he had done so and issued unqualified opinions regarding those financial statements.

The courts found that Friehling also had a conflict of interest and, as a result was not independent in his relationship with Madoff Investment Securities. Friehling and his family members had investment

---

advisory accounts at Madoff Investment Securities, with Friehling’s investments exceeding $500,000, according to his testimony. No disclosure of this fact was ever made in Friehling’s reports.

Friehling also plead guilty to aiding and abetting a device, scheme or artifice to defraud. This charge was a result of the finding that financial statements that were certified by Friehling were materially false.

Investors of Madoff Investment Securities relied upon these statements, which were filed with the SEC, to make investment decisions. This resulted in the charging of Friehling for securities fraud, investment advisor fraud, and making false filings with the SEC. Friehling pled guilty to these charges.

Finally, Friehling pled guilty to impeding the administration of the IRS laws. From 1991 through 2008, Friehling assisted in the preparation of numerous false tax returns, with corrupt intent, for Madoff as well as others, according to the courts.

While Friehling still maintains that he knew nothing of Madoff’s engagement in a Ponzi scheme, in his testimony to the court he stated: “In what is surely the biggest mistake of my life I placed my trust in Bernard Madoff.”

**Do you think that the biggest mistake that Friehling made was putting his trust in Madoff? If not, what do you think was his biggest mistake?**

In May 2015, U.S. District Judge Laura Taylor Swain sentenced Friehling to one year of home detention and one year of supervised release. Friehling avoided prison because he cooperated extensively with federal prosecutors and because he had been unaware of the extent of Madoff’s crimes. Addressing the court at the hearing, Friehling apologized to Madoff’s victims. Referring to Madoff’s reported statement that he was a "dumb auditor," Friehling said: "I would rather be regarded as dumb than crooked. I did not question what I should have questioned."

As a successful CPA with a wife and three children, Friehling compromised his core values of integrity, objectivity, and independence for what he perhaps believed would make him even more successful.
Integrity, Objectivity, and Independence: Core Values of the Profession

Integrity, objectivity and independence are the core values of the CPA profession. They are discussed in both the TSBPA Rules of Professional Conduct and the AICPA Code of Professional Conduct.

“Honor is better than honors.” - Abraham Lincoln

Case Study: Integrity, Objectivity, and Independence—Arthur Andersen

Founded in 1913 in Chicago, Illinois, Arthur Andersen was an organization that was committed to integrity, objectivity and independence. Its founder, Arthur Andersen, donated more than $5 million dollars to universities for awareness of ethical issues pertaining to business. Anderson considered ethics to be the backbone of the firm. Anderson died in 1947.

After his death, it appears those values were lost, and the greed of corporate officers and company partners led to the scandals associated with WorldCom, Waste Management, and Enron. What was once recognized as one of the top accounting and auditing firms in the nation, Arthur Anderson is a firm that has lost its honor.

Texas Rule §501.73: Integrity and Objectivity

(a) A person in the performance of professional accounting services or professional accounting work shall maintain integrity and objectivity, shall be free of conflicts of interest and shall not knowingly misrepresent facts nor subordinate his or her judgment to others. In tax practice, however, a person may resolve doubt in favor of his client as long as any tax position taken complies with applicable standards such as those set forth in Circular 230 issued by the Internal Revenue Service and AICPA Statements on Standards for Tax Services.

(b) A conflict of interest may occur if a person performs a professional accounting service or professional accounting work for a client or employer and the person has a relationship with another person, entity, product, or service that could, in the person's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the person's objectivity. If the person believes that the professional accounting service or professional accounting work can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, then this rule shall not operate to prohibit the performance of the professional accounting service or professional accounting work because of a conflict of interest.

(c) Certain professional engagements, such as audits, reviews, and other services, require independence. Independence impairments under §501.70 (relating to Independence), its interpretations and rulings cannot be eliminated by disclosure and consent.

(d) A person shall not concurrently engage in the practice of public accountancy and in any other business or occupation which impairs independence or objectivity in rendering professional accounting services or professional accounting work, or which is conducted so as to augment or benefit the accounting practice unless these rules are observed in the conduct thereof.”

---

12 Texas Board of Accountancy, Rule 501.73, effective 2/17/2008.
Case Study: TSBPA Enforcement Action

May 2009

Investigation No:09-03-07L
Respondent: Eric Duane Boyt
Hometown: Midland
License No.:066929

Rules Violations: 501.12 (now 501.73), 501.41(9) [now 501.90(9)], 501.41(13) [now 501.90(12)] Act
Violations: 901.502(6) & 901.502(11)

Respondent entered into an Agreed Consent Order with the Board whereby Respondent involuntarily surrendered his certificate. In addition, Respondent must pay $10,000 in administrative penalties in nine installments, with the first installment of $2,000 due within thirty (30) days of the date the Board ratified the Agreed Consent Order and each subsequent installment of $1,000 due every 30 days thereafter.

In December 1999, Respondent was employed as an accountant by Enron Corp. As part of Respondent’s duties, he determined the accounting consequences of pending transactions in which Enron was involved. One of those transactions was Enron’s proposed sale of barges located off the coast of Nigeria to Merrill Lynch. Although Respondent learned that Enron had promised Merrill Lynch that Enron would buy back the barges if Merrill Lynch could not find a buyer within six months, a promise that would jeopardize the accounting and eliminate the gain, Respondent was involved in removing all references to that promise in order to obtain the transaction by Arthur Andersen. In addition, he signed off on the deal-approval sheet (DASH) for this transaction as required by the risk assessment division in Enron and was prepared to lie about the true nature of the transaction.

The AICPA Code of Professional Conduct states that: “To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.” Integrity is defined as:

“an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.”

Integrity means observing both the form and the spirit of technical and ethical standards. The Code notes that while integrity requires a CPA to be honest (it cannot accommodate deceit or subordination of principle), it also requires the CPA to recognize the constraints of client confidentiality. In addition, service and the public trust should not be subordinated to personal gain and advantage.

While integrity can be measured in terms of what is right or wrong, objectivity is a state of mind. According to the Code, the principle of objectivity imposes the obligation to be:

- impartial,
- intellectually honest, and
- free of conflicts of interest.

13 AICPA Code of Professional Conduct, ET Section 0.300.040.01.
ET Section 0.300.030.04 of the AICPA Code states:

“Those who rely on members expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services—all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct.”

ET Section 1.100.001.01 also states that:

“In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.”14

A CPA may be considered in violation of this rule if he or she:

- Makes, permits or directs another to make, materially false and misleading entries in an entity’s financial statements or records.
- Fails to correct an entity’s financial statements or records that are materially false and misleading when he or she has the authority to record an entry.
- Signs, or permits or directs another to sign, a document containing materially false and misleading information.15

Conflicts of interest should be considered for those in public practice when, for example:

- Providing corporate finance services to a client seeking to acquire an audit client of the firm, when the firm has obtained confidential information during the course of the audit that may be relevant to the transaction;
- Advising two clients at the same time who are competing to acquire the same company when the advice might be relevant to the parties’ competitive positions;
- Providing services to both a vendor and a purchaser who are clients of the firm in relation to the same transaction;
- Preparing valuations of assets for two clients who are in an adversarial position with respect to the same assets;
- Representing two clients at the same time regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership;
- Providing a report for a licensor on royalties due under a license agreement while at the same time advising the licensee of the correctness of the amounts payable under the same license agreement;
- Advising a client to invest in a business in which, for example, the immediate family member of the member has a financial interest in the business;
- Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a competitor of the client;
- Advising a client on the acquisition of a business that the firm is also interested in acquiring;
- Advising a client on the purchase of a product or service while having a royalty or commission agreement with one of the potential vendors of that product or service;

---

15 ET Section 1.130.010.01
- Providing forensic investigation services to a client for the purpose of evaluating or supporting contemplated litigation against another client of the firm;
- Providing tax or personal financial planning services for several members of a family whom the member knows to have opposing interests; or
- Referring a personal financial planning or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement.16

*Case Study: The Reporting Dilemma*

Working for a company with an outstanding credit line and covenants that are required to be met in order for the line not to become due and payable in full can be a real challenge for a controller. As the person in charge of reporting the financial statements, Sue Smith found herself in uncomfortable situations numerous times with this issue, and with one company in particular. “Our biggest problem was the accounts receivable balance.” Sue explains.

The company provided training workshops to industry. The contracts for the workshops stated the dates that the workshops were to be held and that, in the event a workshop was cancelled by a client, the full amount of the contract would be due in full (a no cancellation policy).

The problem was that many of the contracts stating this policy were not being signed by the client. Although there were verbal agreements that this was the cancellation policy, without a written agreement, Sue did not feel it was appropriate to accrue the revenue on the financial statements. However, if she did not, it could mean that the line of credit would become due and payable. This was a real problem, because the company depended on the accounts receivable balance to meet their current ratio covenant. She felt she would let her company and all of its employees down if she did not do her best to meet the covenant requirements. Or would she? It wasn’t her responsibility to make sure the contracts got signed by the clients? Her responsibility was to report accurate and timely financial information. Sue finally decided that she could not report on a contract that was not signed.

**What would you do?**

Sue refused to accrue the revenue for the unsigned contracts. Yes, there were some complaints in the beginning, but thanks to the fax machine and a few fast moving sales representatives and clients, they were always able to get a signed copy when they needed it. Sue also noticed that fewer and fewer unsigned contracts appeared and as a result, the board of directors seemed to have more faith in Sue’s ability to control the financial processes.

**Independence**

Upholding the values of integrity and objectivity calls for avoiding both actual and apparent conflicts of interest. This is also referred to as being independent both in fact and in appearance.

**Independence of mind.** The state of mind that permits the performance of an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

16 ET Section 1.110.010.04.
Independence in appearance. The avoidance of circumstances that would cause a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or a member of the attest engagement team had been compromised.\textsuperscript{17}

The Texas Rules of Professional Conduct require that all CPAs, whether they are members of the AICPA or not, conform in fact and in appearance to the independence standards established by the AICPA and the Board, and, where applicable, the U.S. Securities and Exchange Commission, the General Accounting Office and other regulatory or professional standard setting bodies.

“Covered members” are required to comply with the independence rules under the AICPA Code of Professional Conduct. Covered members include:

- An individual on the client’s attest engagement team
- An individual in a position to influence the client’s attest engagement
- A partner or manager who provides more than 10 hours of nonattest services to the attest client
- A partner in the office in which the lead attest engagement partner primarily practices in connection with the client’s attest engagement
- The firm, including the firm’s employee benefit plans
- An entity whose operating, financial, or accounting policies can be controlled by any of the individuals or entities described in items 1–5 or by two or more such individuals or entities if they act together.”\textsuperscript{18}

\textbf{Exception}: The Code prohibits these relationships if you are a partner or professional employee in a public accounting firm, even if you are not a covered member:

- Director, officer, or employee (or in any capacity equivalent to a member of management) of the client, promoter, underwriter, voting trustee, or trustee of any of the client’s employee benefit plans
- Owner of more than 5 percent of an attest client’s outstanding equity securities (or other ownership interests).

ET Section 1.295.010.07, Independence, of the AICPA Code of Professional Conduct requires the following in respect to a CPA’s independence when performing an attest engagement:

- “A member should consult the rules of his or her state board of accountancy, his or her state CPA society,
- If the members report will be filed with the U.S. Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB) and the SEC rules should also be reviewed.
- If the member's report will be filed with the U.S. Department of Labor (DOL), the DOL rules should be reviewed.
- If law, regulation, agreement, policy or contract requires the member's report to be filed under the Government Accountability Office (GAO) regulations, the GAO rules should be reviewed.
- Any other organization that issues or enforces standards of independence that would apply to the member's engagement should also be reviewed. Such organizations may have

\textsuperscript{17} ET Section 0.400.21.

\textsuperscript{18} AICPA, AICPA Professional Standards: Code of Professional Conduct and Bylaws as of June 1, 2005 (New York: AICPA, 2005.)
independence requirements or rulings that differ from (e.g., may be more restrictive than) those of the AICPA.\footnote{19}

Knowing that it is impossible to address all potential independence conflicts which may occur, the AICPA requires that accountants use the risk-based approach to address matters which are not specifically discussed in the Code.

**Risk-Based Approach to Independence**

Applying the risk-based approach when determining independence generally means that when threats to independence reach an unacceptable level, safeguards must be applied to eliminate the threats or reduce them to an acceptable level. In cases where threats to independence are at an unacceptable level, and thereby require the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level must be documented.

ET Section 1.210.010, *Conceptual Framework for Independence (AICPA)*, details the requirements of the risk-based approach to analyzing independence matters, as summarized below.

**Steps Required Under the Risk-Based Approach to Independence**

1. **Identify and evaluate threats to independence**—Identify and evaluate threats, both individually and in the aggregate, because threats can have a cumulative effect on a member’s independence. Where threats are identified but, due to the types of threats and their potential effects, such threats are considered to be at an acceptable level (that is, it is not reasonable to expect that the threats would compromise professional judgment), the consideration of safeguards is not required. If identified threats are not considered to be at an acceptable level, safeguards should be considered.

2. **Determining whether safeguards already eliminate or sufficiently mitigate identified threats and whether threats that have not yet been mitigated can be eliminated or sufficiently mitigated by safeguards**—Different safeguards can mitigate or eliminate different types of threats, and one safeguard can mitigate or eliminate several types of threats simultaneously. When threats are sufficiently mitigated by safeguards, the threats’ potential to compromise professional judgment is reduced to an acceptable level. A threat has been sufficiently mitigated by safeguards if, after application of the safeguards, it is not reasonable to expect that the threat would compromise professional judgment.

   **Note:** In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented as required under ET Section 1.210.010.09.

3. **If no safeguards are available to eliminate an unacceptable threat or reduce it to an acceptable level, independence would be considered impaired.**

**Definitions Related to Independence**

- **Impair**—For purposes of this framework, impair means to effectively extinguish independence. When a member’s independence is impaired, the member is not independent.
- **Threats**—Threats to independence are circumstances that could impair independence. Whether independence is impaired depends on the nature of the threat, whether it would be reasonable to expect that the threat would compromise the member’s professional judgment.

\footnote{19} Ibid.
and, if so, the specific safeguards applied to reduce or eliminate the threat, and the effectiveness of those safeguards.

- **Safeguards**—Controls that mitigate or eliminate threats to independence. Safeguards range from partial to complete prohibitions of the threatening circumstance to procedures that counteract the potential influence of a threat. The nature and extent of the safeguards to be applied depend on many factors, including the size of the firm and whether the client is a public interest entity. To be effective, safeguards should eliminate the threat or reduce to an acceptable level the threat’s potential to impair independence.

### Categories of Threats to Independence

1. **Self-review** - Members reviewing, as part of an attest engagement, evidence that results from their own or their firm’s nonattest work, such as preparing source documents used to generate the client’s financial statements. There is also the threat that a member will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the member or an individual in the employing organization, and that the member will rely on that service in forming a judgment as part of another service.

   Examples of self-review threats include:
   i. When performing an internal audit procedure, an internal auditor accepts work that he or she previously performed in a different position.
   ii. The member accepts the work previously performed by the member, alone or with others, that will be the basis for providing another professional service.

2. **Advocacy** - Actions promoting an attest client’s interests or position;

   i. Promoting the client’s securities as part of an initial public offering
   ii. Representing a client in U.S. tax court.

   Or, the threat that a member will promote an employing organization’s interests or position to the point that his or her objectivity is compromised.

   Examples of advocacy threats include:
   i. Obtaining favorable financing or additional capital is dependent upon the information that the member includes in, or excludes from, a prospectus, an offering, a business plan, a financing application, or a regulatory filing.
   ii. The member gives or fails to give information that the member knows will unduly influence the conclusions reached by an external service provider or other third party.

3. **Adverse interest** - Actions or interests between the member and the client that are in opposition, such as, commencing, or the expressed intention to commence, litigation by either the client or the member against the other, or the threat that a member will not act with objectivity because the member’s interests are opposed to the interests of the employing organization.

   Examples of adverse interest threats include:
   i. A member has charged, or expressed an intention to charge, the employing organization with violations of law.
   ii. A member or the member’s immediate family or close relative has a financial or another relationship with a vendor, customer, competitor, or potential acquisition of the employing organization.
   iii. A member has sued or expressed an intention to sue the employing organization or its officers, directors, or employees.
(4) **Familiarity**- Members having a close or longstanding relationship with an attest client or knowing individuals or entities (including by reputation) who performed nonattest services for the client.
   i. A member of the attest engagement team whose spouse is in a key position at the client, such as the client’s chief executive officer
   ii. A partner of the firm who has provided the client with attest services for a prolonged period
   iii. A member who performs insufficient audit procedures when reviewing the results of a nonattest service because the service was performed by the member’s firm
   iv. A member of the firm having recently been a director or officer of the client
   v. A member of the attest engagement team whose close friend is in a key position at the client.

Also included is the threat that, due to a long or close relationship with a person or an employing organization, a member will become too sympathetic to their interests or too accepting of the person’s work or employing organization’s product or service.

Examples of familiarity threats include:
   i. A member uses an immediate family’s or a close relative’s company as a supplier to the employing organization.
   ii. A member may accept an individual’s work product with little or no review because the individual has been producing an acceptable work product for an extended period of time.
   iii. A member’s immediate family or close relative is employed as a member’s subordinate.
   iv. A member regularly accepts gifts or entertainment from a vendor or customer of the employing organization.

(5) **Undue influence** - Attempts by an attest client’s management or other interested parties to coerce the member or exercise excessive influence over the member.
   i. A threat to replace the member or the member’s firm over a disagreement with client management on the application of an accounting principle
   ii. Pressure from the client to reduce necessary audit procedures for the purpose of reducing audit fees
   iii. A gift from the client to the member that is other than clearly insignificant to the member
   iv. Or the threat that a member will subordinate his or her judgment to that of an individual associated with the employing organization or any relevant third party due to that individual’s position, reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member.

Examples of undue influence threats include:
   i. A member is pressured to become associated with misleading information.
   ii. A member is pressured to deviate from a company policy.
   iii. A member is pressured to change a conclusion regarding an accounting or a tax position.
   iv. A member is pressured to hire an unqualified individual.

(6) **Financial self-interest** - Potential benefit to a member from a financial interest in, or from some other financial relationship with, an attest client.
   i. Having a direct financial interest or material indirect financial interest in the client
   ii. Having a loan from the client, from an officer or director of the client, or from an individual who owns 10 percent or more of the client’s outstanding equity securities
   iii. Excessive reliance on revenue from a single attest client
   iv. Having a material joint venture or other material joint business arrangement with the client.
For those in business, the threat that a member could benefit, financially or otherwise, from an interest in, or relationship with, the employing organization or persons associated with the employing organization.

Examples of self-interest threats include:

i. A member’s immediate family or close relative has a financial interest in the employing organization.

ii. A member holds a financial interest (for example, shares or share options) in the employing organization, and the value of that financial interest is directly affected by the member’s decisions.

iii. A member is eligible for a profit or other performance-related bonus, and the value of that bonus is directly affected by the member’s decisions.

(7) **Management participation** - Taking on the role of client management or otherwise performing management functions on behalf of an attest client.

i. Serving as an officer or director of the client

ii. Establishing and maintaining internal controls for the client

iii. Hiring, supervising, or terminating the client’s employees

### Categories of Safeguards for Independence

1. **Safeguards created by the profession, legislation, or regulation** – Examples include but are not limited to education and training requirements on independence and ethics rules for new professionals, professional standards and monitoring and disciplinary processes, external review of a firm’s quality control system, legislation governing the independence requirements of the firm, and competency and experience requirements for professional licensure.

2. **Safeguards implemented by the attest client** - Examples include but are not limited to safeguards such as the attest client has personnel with suitable skill, knowledge, and/or experience who make managerial decisions with respect to the delivery of nonattest services by the member to the attest client or a tone at the top that emphasizes the attest client’s commitment to fair financial reporting.

3. **Safeguards implemented by the firm, including policies and procedures to implement professional and regulatory requirements** - Examples include but are not limited to safeguards such as firm leadership that stresses the importance of independence and the expectation that members of attest engagement teams will act in the public interest or policies and procedures that are designed to implement and monitor quality control in attest engagements.

4. **Examples of safeguards implemented by the employing organization are as follows:**

   a. A tone at the top emphasizing a commitment to fair financial reporting and compliance with applicable laws, rules, regulations, and corporate governance policies

   b. Policies and procedures addressing ethical conduct and compliance with laws, rules, and regulations

   c. Audit committee charter, including independent audit committee members

   d. Internal policies and procedures requiring disclosure of identified interests or relationships among the employing organization, its directors or officers, and vendors, suppliers, or customers

   e. Internal policies and procedures related to purchasing controls

   f. Internal policies and procedures related to customer acceptance or credit limits
g. Dissemination of corporate ethical compliance policies and procedures, including whistle-blower hotlines, the reporting structure, dispute resolution, or other similar policies, to promote compliance with laws, rules, regulations, and other professional requirements

h. Human resource policies and procedures safeguarding against discrimination or harassment, such as those concerning a worker’s religion, sexual orientation, gender, or disability

i. Human resource policies and procedures stressing the hiring and retention of technically competent employees

j. Policies and procedures for implementing and monitoring ethical policies

k. Assigning sufficient staff with the necessary competencies to projects and other tasks

l. Policies segregating personal assets from company assets

m. Staff training on applicable laws, rules, and regulations

n. Regular monitoring of internal policies and procedures

o. A reporting structure whereby the internal auditor does not report to the financial reporting group

p. Policies and procedures that do not allow an internal auditor to monitor areas where the internal auditor has operational or functional responsibilities

q. Policies for promotion, rewards, and enforcement of a culture of high ethics and integrity

r. Use of third-party resources for consultation as needed on significant matters of professional judgment.
Case Study - Performance of Nonattest Services (Interpretation 101-3)

The following is a case study reported in the *Journal of Accountancy* (December, 2007) illustrating independence issues when performing nonattest services:

Construct Inc. is a small, family-owned-and-managed construction company that provides services to residential and commercial customers. The company employs George, an accountant who maintains the books and records, is familiar with GAAP and can prepare the financial statements. Because of a shortage of internal resources required to do the work, Construct engaged its practitioner to help process the company’s payroll. George oversaw the services in which the practitioner:

- Used approved timecards and other client records to calculate the payroll and generate unsigned checks for the client’s signature. Transmitted payroll data to the client’s financial institution (pre-authorized by the client).
- Submitted electronic payroll tax payments in accordance with U.S. Treasury Department and other relevant jurisdictions’ guidelines under arrangements made with the client and its financial institution.

George assumed all management responsibilities for the practitioner’s services. He also performed control activities related to payroll. These duties included spot-checking the payroll for accuracy by recalculating the payroll for select employees and comparing his amounts to those the practitioner calculated, reviewing disbursements to gauge consistency with prior periods and investigating any inconsistencies. The practitioner considered George capable of overseeing the payroll work for independence purposes.

However, during the audit, the practitioner identified a significant deficiency in internal control over financial reporting. He learned that George misclassified payroll expense between contracts when posting the job cost ledger. This would have caused a misstatement in the financial statements.

**Does the practitioner’s identification of a significant deficiency or material weakness in internal control over financial reporting in an area in which he or she previously performed nonattest services impair independence?**

Construct Inc. and the practitioner agreed to the responsibilities that each would undertake in connection with the payroll services engagement. This ensured that the practitioner would not assume management’s responsibilities for the payroll process. Therefore, the fact that the practitioner concluded during the audit that a significant deficiency (or even a material weakness) in ICFR existed does not mean that independence was impaired when the payroll services were performed.


Part I Review

(Answers and explanations appear after the Glossary)

1. An accountant who follows a rule even though it might not be in her client’s best interest is probably thinking along the lines of which of the following ethical theories?
   A. Utilitarianism
   B. Deontology
   C. Ethics of care
   D. Principles-based ethics

2. The AICPA Code of Professional Conduct states that a CPA should maintain integrity and objectivity. Objectivity in the Code refers to a CPA’s ability
   A. To maintain impartiality on all matters that come under the CPA’s review.
   B. To independently distinguish between accounting practices that are acceptable and those that are not.
   C. To be unyielding in all matters dealing with auditing procedures.
   D. To independently choose between alternate accounting principles and auditing standards.

3. In the AICPA Code of Professional Conduct, observing both the form and the spirit of technical and ethical standards relates to the principle of
   A. Objectivity.
   B. Integrity.
   C. Independence.
   D. Wisdom.

4. The appearance of independence of a CPA is most likely to be impaired if the CPA
   A. Provides appraisal, valuation, or actuarial services for an attest client.
   B. Joins a trade association, which is an attest client, and serves in a nonmanagement capacity.
   C. Accepts a token gift from an attest client.
   D. Serves as an executor and trustee of the estate of an individual who owned the majority of the stock of a closely held client corporation.

5. A violation of the profession’s ethical standards would most likely have occurred when a CPA
   A. Made arrangements with a bank to collect notes issued by a client in payment of fees due.
   B. Joined an accounting firm made up of three non-CPA practitioners.
   C. Expressed an unqualified opinion on the year 2 financial statements when fees for the year 1 audit were unpaid.
   D. Purchased a bookkeeping firm's practice of monthly write-ups for a percentage of fees to be received over a 3-year period.

6. In exercising due professional care, an auditor should
   A. Exercise professional skepticism.
   B. Examine all available corroborating evidence and seek to obtain an absolute level of assurance that management’s assertions are accurate.
   C. Design the audit to detect all instances of fraud.
   D. Base his level of skepticism on the perceived honesty of management.
7. A CPA's retention of client records as a means of enforcing payment of an overdue audit fee is an action that is
   A. Not addressed by the AICPA Code of Professional Conduct.
   B. Acceptable if sanctioned by state law.
   C. Prohibited under the AICPA Code of Professional Conduct.
   D. A violation of GAAS.

8. A violation of the profession's ethical standards most likely would have occurred when a CPA
   A. Compiled the financial statements of a client that employed the CPA's spouse as a bookkeeper.
   B. Received a fee for referring audit clients to a company that sells limited partnership interests.
   C. Performed a valuation of a client's business.
   D. Arranged with a financial institution to collect notes issued by a client in payment of fees due.
Part II. Texas Rules of Professional Conduct

History of the Texas Rules of Professional Conduct

Before we begin covering the Texas Rules of professional Conduct and select enforcement actions taken by the Board, it may interest you to learn the history of why and how the rules were established. In its February 2010 edition of the Texas State Board Report (VOL. 102), the Board reported how the enforcement procedures and policies of the Texas State Board of Public Accountancy (TSBPA) have evolved over the past 95 years.

The Rules of Professional Conduct were promulgated under the Public Accountancy Act, which directs the Texas State Board of Public Accountancy to promulgate rules of professional conduct "in order to establish and maintain high standards of competence and integrity in the practice of public accountancy and to insure that the conduct and competitive practices of licensees serve the purposes of the Act and the best interest of the public."

In 1915, the Public Accountancy Act established a Board of five members to examine and certify accountants within the State of Texas. While the Board did investigate and attempt to maintain the professionalism of accountants in Texas, it was not until 30 years later that it was actually given the authority to establish and enforce any rules of professional conduct.

In 1929, the Texas Society of CPA’s established the first code of ethics for certified public accountants. While expectations of professional conduct were outlined in this code, enforcement actions for infractions of the code would merely mean that you would not be allowed to be a member of the Society.

However, in 1945 The Public Accountancy Act was significantly revised to meet the demands of the public for increasing education, experience requirements and professionalism within the field of accounting. The Board would now have the ability to create and enforce rules of professional conduct, as well as establish specific education and experience requirements for those licensed by the Board.

On September 1, 1946, the Rules of Professional Conduct went into effect. Through the process of establishing the rules, the Board required that all existing license holders vote on the rules.

Again revised in 1961, the Public Accountancy Act provided the Board with subpoena powers and streamlined the requirements for enforcement procedures.

The Board soon realized that it may be considered inappropriate for it to both investigate complaints against CPAs as well as to make judgments on those cases. For this reason, the Board created committees whose job it is to review the cases, hear arguments for the enforcement action and finally make recommendations to the Board regarding what action if any should be taken.

Currently there are three committees which hear complaints. Technical Standards Review (TSR) I and II committees are assigned to hear cases alleging violations of technical standards, while the Behavioral Enforcement Committee (BEC) hears all cases alleging misconduct which is not related to attest services. The members of each committee are appointed by the presiding officer of the TSBPA.

The Rules of Professional Conduct are intended to be applicable to all professional services performed in the practice of public accountancy, including services relating to:

- accounting, auditing and other assurance services,
- taxation,
- financial advisory services,
• litigation support,
• internal auditing,
• forensic accounting, and
• management advice and consultation.

**Applying the Rules of Professional Conduct**

The TSBPA regulates the accounting profession in an effort to provide competent, objective accountants and auditors for Texas’ financial markets, banking systems, and businesses. The Board’s major functions include:

- Administering the Uniform Certified Public Accountant (CPA) Examination;
- Certifying and licensing accountants who have passed the Exam and met all requirements;
- Registering firms engaged in the practice of public accountancy; and
- Enforcing provisions of the Public Accountancy Act, and taking disciplinary action when necessary.

The TSBPA’s efforts include ensuring that appropriate action is taken and that due process is carried out in all enforcement cases. The staff annually investigates and prosecutes approximately 300 alleged violations of the rules of professional conduct and the statute.

The TSBPA’s disciplinary process begins with a complaint, filed either by a member of the public, another government entity, or on the Board’s own initiative. A staff investigation follows, sometimes with the assistance of an outside technical consultant.

The TSBPA designates certain investigations as "major cases." These involve CPA firms implicated in the audits of failed or troubled savings and loan organizations, financial institutions, insurance companies, and other cases of a major nature. Such cases are more complex and require substantial resources for pre-hearing preparations and prosecution. The Board engages the Texas Attorney General’s office to assist in the prosecutorial process.

**Professional Standards**

The Rules of Professional Conduct (Rules) establish the following Professional Standards:

- A CPA should not permit his or her name to be associated with financial statements in such a manner as to imply that he or she is acting as an auditor with respect to such financial statements, unless he or she has complied with applicable generally accepted auditing standards.

- A CPA should not issue a report asserting that financial statements are presented in conformity with generally accepted accounting principles if such financial statements contain any departure from such accounting principles which has a material effect on the financial statements taken as a whole, unless the certificate or registration holder can demonstrate that by reason of unusual circumstances the financial statements would otherwise have been misleading. In such a case, the certificate or registration holder’s report must describe the departure, the approximate effects thereof, if practicable, and the reasons why compliance with the generally accepted accounting principles would result in a misleading statement.

- A CPA in the performance of consulting services, accounting and review services, any other attest service, or tax services shall conform to the professional standards applicable to such services.
• A CPA in the client practice of public accountancy must comply with SSARS or another similar standards of a national or international accountancy organization recognized by the board when transmitting a client's financial statements to the client or a third party. A CPA not employed in the client practice of public accountancy may prepare his employer's financial statements and may issue non-attest transmittals or information regarding non-attest transmittals without a firm license, provided those transmittals do not purport to be in compliance with SSARS or any other similar standard of a national or international accountancy organization recognized by the board.

**Case Study: Attestation Engagement**

May 2015

Investigation Nos.: 10-05-02L, 12-12-04L, 11-06-18L  
Respondents: BDO Seidman, LLP, BDO USA, LLP & Carlos Ancira  
Hometowns: Dallas, TX & Austin, TX  
Certificate No.: 017745  
Firm License Nos.: P04666 & P05552  
Rule Violations: 501.60, 501.61, 501.74(b)  
Act Violations: 901.502(6), 901.502(11)

Respondents have entered into an ACO with the Board whereby BDO USA, LLP accepted a reprimand and Carlos Ancira, CPA accepted a three-year suspension of his license. In addition, the firm agreed to contribute $2.65M to the state’s general revenue fund and will pay the Board $250,000 in administrative costs.

Respondents failed to obtain reasonable assurance that the financial statements were free of material misstatements in its audits of Stanford Group Company (SGC). Respondents were responsible for the issuance of the audit reports asserting that the financial statements were presented in conformity with generally accepted accounting principles when such financial statements in fact contained material departures. Respondents failed to exercise due professional care in the performance of professional services during the audits of SGC.

**Responsibilities to Clients**

In addition to the above Professional Standards, the Rules also require that all CPAs, whether they are members of the AICPA or not, conform in fact and in appearance to the independence standards established by the AICPA and the Board, and, where applicable, the U.S. Securities and Exchange Commission, the General Accounting Office and other regulatory or professional standard setting bodies.

Included in the section *Responsibilities to Clients* of the Rules are the restriction regarding commissions and contingency fees. In general, a CPA or CPA firm may not receive a commission or contingency fee when the licensee or the licensee's firm also performs services for that client in which independence is required. There are also disclosure requirements for instances in which a commission or contingency fee is accepted.
**Board Ruling: Testifying as an Expert and Contingent Fees**

The Board has ruled that a consulting accounting expert may become a testifying accounting expert when the client for whom he is working makes his work available to a testifying expert. A consulting accounting expert who is working on a contingent fee basis should work closely with his client to insure that he does not inadvertently become a testifying expert through the actions of his client. An accounting expert may not accept a contingent fee for part of an engagement and a set fee for part of the same engagement.

A consulting accounting expert who becomes a testifying expert may not accept a contingent fee for the part of his work done as a consultant, but must be compensated on a set fee basis for all of the work performed on the same engagement. A consulting accounting expert who enters into a contingent fee engagement should reach an agreement, preferably in writing, with the client as to how he will be compensated should he become a testifying expert prior to beginning the engagement.

**Integrity and Objectivity in the Performance of Accounting Services**

A person in the performance of professional accounting services or professional accounting work shall maintain integrity and objectivity, shall be free of conflicts of interest and shall not knowingly misrepresent facts nor subordinate his or her judgment to others. In tax practice, however, a person may resolve doubt in favor of his or her client as long as any tax position taken complies with applicable standards such as those set forth in Circular 230 issued by the Internal Revenue Service and AICPA Statements on Standards for Tax Services.

A conflict of interest may occur if a person performs a professional accounting service or professional accounting work for a client or employer and the person has a relationship with another person, entity, product, or service that could, in the person's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the person's objectivity. If the person believes that the professional accounting service or professional accounting work can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, then this rule shall not operate to prohibit the performance of the professional accounting service or professional accounting work because of a conflict of interest.

Certain professional engagements, such as audits, reviews, and other services, require independence. Independence impairments cannot be eliminated by disclosure and consent.

A person shall not concurrently engage in the practice of public accountancy and in any other business or occupation which impairs independence or objectivity in rendering professional accounting services or professional accounting work, or which is conducted so as to augment or benefit the accounting practice unless these rules are observed in the conduct thereof.
Case Study: Integrity and Objectivity

May 2009

Investigation No:09-03-07L
Respondent: Eric Duane Boyt
Hometown: Midland
License No.:066929
Rules Violations: 501.73, 501.90(9), 501.90(12)] Act Violations:901.502(6) & 901.502(11)

Respondent entered into an Agreed Consent Order with the Board whereby Respondent involuntarily surrendered his certificate. In addition, Respondent must pay $10,000 in administrative penalties in nine installments, with the first installment of $2,000 due within thirty (30) days of the date the Board ratified the Agreed Consent Order and each subsequent installment of $1,000 due every 30 days thereafter.

In December 1999, Respondent was employed as an accountant by Enron Corp. As part of Respondent’s duties, he determined the accounting consequences of pending transactions in which Enron was involved. One of those transactions was Enron’s proposed sale of barges located off the coast of Nigeria to Merrill Lynch. Although Respondent learned that Enron had promised Merrill Lynch that Enron would buy back the barges if Merrill Lynch could not find a buyer within six months, a promise that would jeopardize the accounting and eliminate the gain, Respondent was involved in removing all references to that promise in order to obtain the approval of the transaction by Arthur Andersen. In addition, he signed off on the deal-approval sheet (DASH) for this transaction as required by the risk assessment division in Enron and was prepared to lie about the true nature of the transaction.

Competence in the Performance of Professional Services

The Rules require that a CPA not undertake any engagement for the performance of professional services which he or she cannot reasonably expect to complete with due professional competence. Competence to perform professional accounting services or professional accounting work involves both the technical qualifications of the person and the person's staff and the ability to supervise and evaluate the quality of the work being performed.

If a person is unable to gain sufficient competence to perform professional accounting services or professional accounting work, the person shall suggest to the client the engagement of someone competent to perform the needed professional accounting or professional accounting work service, either independently or as an associate.

In addition, a CPA must exercise due professional care in the performance of professional services. This includes adequately planning and supervising the performance of professional services, obtaining and maintaining appropriate documentation to afford a reasonable basis for conclusions and recommendations in relation to any professional services performed.
Case Study: Competence

September 2015
Investigation Nos.: 15-03-19L & 15-03-20L
Respondents: James Joseph Towey & James J. Towey, P.C. (Firm)
Hometown: Houston, TX
Certificate No.: 060493
Firm License No.: C04781
Rule Violation: 501.74(d)
Act Violation: 901.502(6)

Respondents entered into an ACO with the Board whereby Respondent and Respondent Firm were reprimanded. In addition, Respondent must pay an administrative penalty of $1,000 and $139.37 in administrative costs within 30 days of the date of the Board Order.

Respondent and Respondent Firm, after attempting to collect fees pertaining to litigation support, filed a 1099-C Tax Form with the IRS advising that the client had realized income due to the discharge of indebtedness.

The Rules for confidentiality require that, except by permission of the client or the authorized representatives of the client, a person or any partner, officer, shareholder, or employee of a person shall not voluntarily disclose information communicated to him or her by the client relating to, and in connection with, professional accounting services or professional accounting work rendered to the client by the person.

This does not apply to the information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or it does not prohibit disclosures pursuant to a court order signed by a judge, a congressional or grand jury subpoena, investigations or proceedings under the Act, ethical investigations conducted by private professional organizations, or in the course of peer reviews.

Disposition of Records and Work Papers
Upon request, a CPA or firm must, in all circumstances, provide to the client or former client any accounting or other records belonging to, or obtained from or on behalf of, the client that the CPA removed from the client's premises or received on behalf of the client.

In addition, for a reasonable charge, a CPA must furnish to his client or former client, upon request made within a reasonable time after original issuance of the document in question:

(1) a copy of the client's tax return;

(2) a copy of any report or other document previously issued by the certificate or registration holder to or for such client provided that furnishing such reports to or for a client or former client would not cause the certificate or registration holder to be in violation of the portions of Section 501.60 of the Rules (relating to Auditing Standards) concerning subsequent events;

(3) a copy of the certificate or registration holder's working papers, to the extent that such working papers include records which would ordinarily constitute part of the client's books and records and are not otherwise available to the client.
The Rules define working papers as “those papers developed by the certificate or registration holder incident to the performance of his engagement which do not result in changes to the client's records or are in part of the records ordinarily maintained by the client.” Examples of working papers include but are not limited to the following:

- letters of confirmation and representation;
- excerpts of company documents;
- audit programs;
- internal memoranda;
- schedules;
- flowcharts; and
- narratives.

A CPA, when performing an engagement that is terminated prior to the completion of the engagement, is required to return or furnish the originals of only those records originally obtained by the certificate or registration holder from the client.

Examples of working papers that constitute client records include, but are not limited to:

- worksheets in lieu of books of original entry such as listings and distributions of cash receipts or cash disbursements;
- worksheets in lieu of general ledger or subsidiary ledgers, such as accounts receivable, job cost and equipment ledgers, or similar depreciation records;
- all adjusting and closing journal entries and supporting details when the supporting details are not fully set forth in the explanation of the journal entry; and
- consolidating or combining journal entries and worksheets and supporting detail in arriving at final figures incorporated in an end product such as financial statements or tax returns.

Documentation or working papers required by professional standards for attest services must be maintained in paper or electronic format by a CPA for a period of not less than five years from the date of any report issued in connection with the attest service, unless otherwise required by another regulatory body.

**Case Study: Competence, Discreditable Acts**

<table>
<thead>
<tr>
<th>September 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investigation No.: 15-03-17L</td>
</tr>
<tr>
<td>Respondent: Teresa Ann Byrd</td>
</tr>
<tr>
<td>Hometown: Wills Point, TX</td>
</tr>
<tr>
<td>Certificate No.: 058120</td>
</tr>
<tr>
<td>Firm License No.: C05868</td>
</tr>
<tr>
<td>Rule Violations: 501.74(b), 501.76, 501.90(12)</td>
</tr>
<tr>
<td>Act Violation: 901.502(6)</td>
</tr>
</tbody>
</table>

Respondent entered into an agreed consent order (ACO) with the Board whereby Respondent was reprimanded. In addition, Respondent must pay an administrative penalty of $500 and $75.04 in administrative costs within 30 days of the date of the Board Order.

Respondent failed to respond to a client’s inquiry, failed to return a client’s original records and failed to complete an engagement despite accepting a retainer fee.
Withdrawal or Resignation from an Engagement

The Texas Rules state that if a CPA cannot complete an engagement or employment assignment in a manner that complies with the requirements, the CPA must withdraw from the engagement or resign from the employment assignment and inform either the client or employer (preferably in writing) of the withdrawal or resignation.

Case Study: Competence, Discreditable Acts

<table>
<thead>
<tr>
<th>September 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investigation No.: 14-12-08L</td>
</tr>
<tr>
<td>Respondent: Alison Ann Eddy-Wilkins</td>
</tr>
<tr>
<td>Hometown: Katy, TX</td>
</tr>
<tr>
<td>Certificate No.: 085578</td>
</tr>
<tr>
<td>Firm License No.: R01137</td>
</tr>
<tr>
<td>Rule Violations: 501.90(12), 501.93</td>
</tr>
<tr>
<td>Act Violations: 901.502(6), 901.502(11)</td>
</tr>
</tbody>
</table>

Respondent entered into an ACO with the Board whereby Respondent was reprimanded. In addition, Respondent must pay an administrative penalty of $5,000 and $2,500 in administrative costs within 30 days of the date of the Board Order.

Respondent failed to complete an engagement and failed to respond to Board communications.

License to Practice in Public Accountancy

A CPA may not engage in the practice of public accountancy unless he or she holds a valid license issued by the Texas Board. If for any reason a CPAs license is revoked, they may not continue to use the title or designation "certified public accountant", the abbreviation "CPA", or any other title, designation, word, letter, abbreviation, sign, card, or device tending to indicate that the person is a certified public accountant.

A licensee who is not in the client practice of public accountancy may not in any manner, through use of the CPA designation or otherwise, claim or imply independence from his employer or that the licensee is in the client practice of public accountancy.
**Case Study: Practice of Public Accountancy, Firm License Requirements**

September 2015  
Investigation No.: 15-03-19N  
Respondent: Robert Lamson  
Hometown: Carrollton, TX  
Act Violation: 901.451

Staff initiated an investigation of this matter based on evidence that Respondent was using terms reserved by the Act for individuals and entities holding licenses issued by the Board. Staff determined that Respondent has not held individual or firm licenses issued by the Board during all relevant times.

Respondent used the designation “CPA.” This action constitutes a violation of Act Section 901.451. Respondent offered services to the public that involve the use of accounting, attest or auditing skills. Offering these services while representing to the public that he is licensed by the Board is the practice of public accountancy under Section 901.003 of the Act.

Respondent repeatedly failed to respond to the Board’s attempts to gain Respondent’s compliance. It was therefore necessary for the Board to immediately issue a cease and desist order (CDO) against Respondent.

**Firm License Requirements**

All CPA firms which establish or maintain an office in the state of Texas must have a current firm license issued by the Texas Board. In addition, a CPA is not permitted to provide attest services without holding a current firm license issued by the Texas Board.

Each advertisement or written promotional statement that refers to a CPA's designation and his or her association with an unlicensed entity in the client practice of public accountancy must include the disclaimer: "This firm is not a CPA firm." The disclaimer must be included in conspicuous proximity to the name of the unlicensed entity and be printed in type not less bold than that contained in the body of the advertisement or written statement. If the advertisement is in audio format only, the disclaimer shall be clearly declared at the conclusion of each such presentation.

The previous requirements do not apply with regard to a CPA performing services:

1. As a licensed attorney at law of this state while in the practice of law or as an employee of a licensed attorney when acting within the scope of the attorney's practice of law;
2. As an employee, officer, or director of a federally-insured depository institution, when lawfully acting within the scope of the legally permitted activities of the institution's trust department; or
3. Pursuant to a practice privilege.
Case Study: Firm License Requirements

July 2010

Investigation No.:09-09-17L
Respondent: Garland Bruce Hilton
Hometown: Austin
Certificate No.:056469
Firm License No.:T01393
Rules Violation:501.81
Act Violation:901.502(6)

Respondent entered into an Agreed Consent Order with the Board whereby Respondent was reprimanded. In addition, Respondent must pay $736.43 in administrative costs within 30 days of the Order.


Advertising
The Texas Rules state that a CPA is not permitted to use, or participate in the use of:

(1) Any written, oral, or electronic communication having reference to the person's professional services that contains a false, fraudulent, misleading or deceptive statement or claim; nor
(2) Any written, oral or electronic communication that refers to the person's professional services that is accomplished or accompanied by coercion, duress, compulsion, intimidation, threats, overreaching, or vexatious or harassing conduct.

In addition, it is a violation of the Rules for a CPA to persist in contacting a prospective client when the prospective client has made known to the CPA, or the CPA should have known the prospective client's desire not to be contacted by the person.

In the case of an electronic or direct mail communication, the CPA must retain a copy of the actual communication along with a list or other description of parties to whom the communication was distributed. Such copy must be retained by the person for a period of at least 36 months from the date of its last distribution. This Rule does not apply when:

(1) The communication is made to anyone who is at that time a client of the person;
(2) The communication is invited by anyone to whom it was made; or
(3) The communication is made to anyone seeking to secure the performance of professional services.

In the case of broadcasting, the broadcast must be recorded and the CPA must retain a recording of the actual transmission for at least 36 months.

Firm Names
The following are the general Texas Rules which are applicable to all CPA firms:

(1) A firm name may not contain words, abbreviations or other language that are misleading to the public, or that may cause confusion to the public as to the legal form or ownership of the firm.
(2) A firm licensed by the board may not conduct business, perform or offer to perform services for or provide products to a client under a name other than the name in which the firm is licensed.
Prior to establishing a firm name, a CPA should refer to the Rules regarding several examples of words, abbreviations and other language which is presumed by the Board to be misleading.

The names of a corporation, professional corporation, limited liability partnership, professional limited liability company or other similar legal forms of ownership must contain the form of ownership or an abbreviation thereof, such as "Inc.," "P.C.," "L.L.P." or "P.L.L.C."; except that a limited liability partnership organized before September 1, 1993 is not required to utilize the words "limited liability partnership" or any abbreviation thereof.

The name of a firm that is a sole proprietor must contain the surname of the sole proprietor as it appears on the individual license issued to the sole proprietor by the board.

A partner surviving the death of all other partners may continue to practice under the partnership name for up to two years after becoming a sole proprietor, but must notify the Board within 30 days.

The name of any current or former owner may not be used in a firm name during any period when such owner is prohibited from practicing public accountancy and prohibited from using the title "certified public accountant," "public accountant," or any abbreviation thereof, unless specifically permitted by the board.

A firm licensed by the board is required to report to the board any change in the legal organization of the firm and amend the firm name to comply with this section regarding firm names for the new organization within thirty days of the effective date of such change.

**Case Study: Firm Names**

<table>
<thead>
<tr>
<th>March 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investigation No.:08-03-05L</td>
</tr>
<tr>
<td>Respondent: Daniel Peterson</td>
</tr>
<tr>
<td>Hometown: Dallas</td>
</tr>
<tr>
<td>Certificate No.:033428</td>
</tr>
<tr>
<td>Firm License No.:C02083</td>
</tr>
<tr>
<td>Rules Violation:501.83</td>
</tr>
<tr>
<td>Act Violation:901.502(6)</td>
</tr>
</tbody>
</table>

Respondent entered into an Agreed Consent Order (ACO) with the Board whereby Respondent’s license was revoked. In addition, Respondent must pay $2,000 in administrative penalties and $1,000 in administrative costs within 30 days of the date the Board ratified the order. Further, Respondent must pay $3,000 in administrative penalties within 90 days of the date the Board ratifies the order.

Respondent maintained a firm name of Peterson and Company when Respondent was the only full-time employee of the firm who held a certificate issued by the Board. In addition, Respondent represented to the Board that two or more full-time employees of the firm held certificates issued by the Board.
Discreditable Acts

The Texas Rules state that a person shall not commit any act that reflects adversely on that person's fitness to engage in the practice of public accountancy. A discreditable act includes but is not limited to:

1. Fraud or deceit in obtaining a certificate as a certified public accountant or in obtaining registration under the Act or in obtaining a license to practice public accounting;
2. Dishonesty, fraud or gross negligence in the practice of public accountancy;
3. Violation of any of the provisions of Subchapter J or §901.458 of the Act applicable to a person certified or registered by the board;
4. Final conviction of a felony or imposition of deferred adjudication or community supervision in connection with a criminal prosecution of a felony under the laws of any state or the United States;
5. Final conviction of any crime or imposition of deferred adjudication or community supervision in connection with a criminal prosecution, an element of which is dishonesty or fraud under the laws of any state or the United States, a criminal prosecution for a crime of moral turpitude, a criminal prosecution involving alcohol abuse or controlled substances, or a criminal prosecution for a crime involving physical harm or the threat of physical harm;
6. Cancellation, revocation, suspension or refusal to renew authority to practice as a certified public accountant or a public accountant by any other state for any cause other than failure to pay the appropriate registration fee in such other state;
7. Suspension or revocation of or any consent decree concerning the right to practice before any state or federal regulatory or licensing body for a cause which in the opinion of the board warrants its action;
8. Knowingly participating in the preparation of a false or misleading financial statement or tax return;
9. Fiscal dishonesty or breach of fiduciary responsibility of any type;
10. Failure to comply with a final order of any state or federal court;
11. Repeated failure to respond to a client's inquiry within a reasonable time without good cause;
12. Intentionally misrepresenting facts or making a misleading or deceitful statement to a client, the board, board staff or any person acting on behalf of the board;
13. Giving intentional false sworn testimony or perjury in court or in connection with discovery in a court proceeding or in any communication to the board or any other federal or state regulatory or licensing body;
14. Threats of bodily harm or retribution to a client;
15. Public allegations of a lack of mental capacity of a client which cannot be supported in fact;
16. Voluntarily disclosing information communicated to the person by an employer, past or present, or through the person's employment in connection with accounting services rendered to the employer, except:
   (A) by permission of the employer;
   (B) pursuant to the Government Code, Chapter 554 (commonly referred to as the "Whistle Blowers Act");
   (C) pursuant to:
      (i) a court order signed by a judge; or
      (ii) a summons
         (I) under the provisions of the Internal Revenue Code of 1986 and its subsequent amendments,
(II) the Securities Act of 1933 (15 U.S.C. §77a et seq.) and its subsequent amendments, or
(D) in an investigation or proceeding by the board;
(E) in an ethical investigation conducted by a professional organization of certified public accountants; or
(F) in the course of a peer review under Section 901.159 of the Public Accountancy Act; or
(G) any information that is required to be disclosed by the professional standards for reporting on the examination of a financial statement.
(17) Breaching the terms of an agreed consent order entered by the board or violating any Board Order.

**Board Ruling: Moral Turpitude**

The board has found that any crime of moral turpitude directly relates to the practice of public accountancy. A crime of moral turpitude is defined as a crime involving grave infringement of the moral sentiment of the community. The board has found that any crime involving alcohol abuse or controlled substances directly relates to the practice of public accountancy.

**Case Studies: Discreditable Acts**

<table>
<thead>
<tr>
<th>Date of Action</th>
<th>Violation</th>
<th>Action Taken</th>
</tr>
</thead>
<tbody>
<tr>
<td>September 2015</td>
<td>Respondent pled guilty to bankruptcy fraud, a felony</td>
<td>Respondent entered into an ACO with the Board whereby Respondent’s certificate was revoked in lieu of further disciplinary action.</td>
</tr>
<tr>
<td>July 2015</td>
<td>Respondent was convicted of Misdemeanor DWI 2nd and sentenced to two years of community supervision, subject to additional conditions.</td>
<td>Respondents entered into an ACO with the Board whereby Respondents’ certificate and firm license were revoked for a period of two years from the effective date of the Board Order. However, the revocation was stayed and Respondents were placed on probation for two years and must pay $75.04 in administrative costs within 30 days of the date of the Board Order.</td>
</tr>
<tr>
<td>January 2015</td>
<td>Respondent was convicted of the felony offense of Attempted Capital Murder on August 21, 2014 and was sentenced to life in</td>
<td>Respondent entered into an ACO with the Board whereby Respondent’s certificate and firm license were revoked in lieu of further disciplinary action.</td>
</tr>
<tr>
<td>Date</td>
<td>Event Description</td>
<td>Details</td>
</tr>
<tr>
<td>------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>November 2014</td>
<td>Respondent was convicted of misdemeanor DWI and sentenced to two years community supervision and ordered to pay $3,462.10 in fines, court costs, and restitution and to complete 100 hours of community service.</td>
<td>Respondent entered into an ACO with the Board whereby Respondent’s certificate was revoked from the effective date of the Board Order for a period of three years; however, the revocation was stayed and Respondent was placed on probation for three years.</td>
</tr>
<tr>
<td>March 2014</td>
<td>On March 18, 2014, the Behavioral Enforcement Committee (BEC) found that Saleh AbdelRahim Al-Shaikh admitted under oath to stealing at least $200,000.00 from his employer.</td>
<td>The BEC offered Respondent an ACO ordering his certificate be revoked, and requiring Respondent to pay the Board $25,000 in administrative penalties and pay the Board’s direct administrative costs incurred in the investigation and prosecution of this matter. Respondent did not accept this offer. Pleadings were filed with the State Office of Administrative Hearings (SOAH) and after notice of hearing, Respondent failed to appear. The SOAH Administrative Law Judge (ALJ) granted staff’s Motion for Default, pursuant to Board Rule 519.42(d), resulting in the Board granting a default Order finding that: 1) Respondent violated Board Rules 501.90(2) and 501.90(9), as well as Sections 901.502(6) and 901.502(11) of the Public Accountancy Act; 2) Respondent’s individual certificate be revoked; and, 3) Respondent be assessed $25,000 in administrative penalties; and $326.11 in administrative costs.</td>
</tr>
<tr>
<td>September 2015</td>
<td>Respondent pled guilty to bankruptcy fraud, a felony</td>
<td>Respondent entered into an ACO with the Board whereby Respondent’s certificate was revoked in lieu of further disciplinary action.</td>
</tr>
<tr>
<td>July 2015</td>
<td>Respondent was convicted of Misdemeanor DWI 2nd and sentenced to two years of community supervision, subject to additional conditions.</td>
<td>Respondents entered into an ACO with the Board whereby Respondents’ certificate and firm license were revoked for a period of two years from the effective date of the Board Order. However, the revocation was stayed and Respondents were placed on probation for two years and must pay $75.04 in administrative costs within 30 days.</td>
</tr>
<tr>
<td>Date</td>
<td>Event Description</td>
<td>Documented Action</td>
</tr>
<tr>
<td>------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>January 2015</td>
<td>Respondent was convicted of the felony offense of Attempted Capital Murder on August 21, 2014 and was sentenced to life in prison.</td>
<td>Respondent entered into an ACO with the Board whereby Respondent’s certificate and firm license were revoked in lieu of further disciplinary action.</td>
</tr>
<tr>
<td>November 2014</td>
<td>Respondent was convicted of misdemeanor DWI and sentenced to two years community supervision and ordered to pay $3,462.10 in fines, court costs, and restitution and to complete 100 hours of community service.</td>
<td>Respondent entered into an ACO with the Board whereby Respondent’s certificate was revoked from the effective date of the Board Order for a period of three years; however, the revocation was stayed and Respondent was placed on probation for three years.</td>
</tr>
<tr>
<td>March 2014</td>
<td>On March 18, 2014, the Behavioral Enforcement Committee (BEC) found that Saleh AbdelRahim Al-Shaikh admitted under oath to stealing at least $200,000.00 from his employer.</td>
<td>The BEC offered Respondent an ACO ordering his certificate be revoked, and requiring Respondent to pay the Board $25,000 in administrative penalties and pay the Board’s direct administrative costs incurred in the investigation and prosecution of this matter. Respondent did not accept this offer. Pleadings were filed with the State Office of Administrative Hearings (SOAH) and after notice of hearing, Respondent failed to appear. The SOAH Administrative Law Judge (ALJ) granted staff’s Motion for Default, pursuant to Board Rule 519.42(d), resulting in the Board granting a default Order finding that: 1) Respondent violated Board Rules 501.90(2) and 501.90(9), as well as Sections 901.502(6) and 901.502(11) of the Public Accountancy Act; 2) Respondent’s individual certificate be revoked; and, 3) Respondent be assessed $25,000 in administrative penalties; and $326.11 in administrative costs.</td>
</tr>
</tbody>
</table>

**Reportable Events**

(a) A CPA must report in writing to the Board the occurrence of any of the following events within 30 days of the date the CPA has knowledge of these events:

1. The conviction or imposition of deferred adjudication of the licensee of any of the following:
   - (A) a felony;
(B) a crime of moral turpitude;
(C) any crime of which fraud or dishonesty is an element or that involves alcohol abuse or controlled substances; and
(D) any crime related to the qualifications, functions, or duties of a public accountant or certified public accountant, or to acts or activities in the course and scope of the practice of public accountancy or as a fiduciary.

(2) The cancellation, revocation, or suspension of a certificate, other authority to practice or refusal to renew a certificate or other authority to practice as a certified public accountant or a public accountant, by any state, foreign country or other jurisdiction;

(3) The cancellation, revocation, or suspension of the right to practice as a certified public accountant or a public accountant before any governmental body or agency or other licensing agency;

(4) An unappealable adverse finding in any state or federal court or an agreed settlement in a civil action against the licensee concerning professional accounting services or professional accounting work; or

(5) The loss of a professional license from another state or federal regulatory agency such as an insurance license or a securities license, resulting from an unappealable adverse finding.

(b) The report required by subsection (a) of this section shall be signed by the licensee and shall set forth the facts which constitute the reportable event. If the reportable event involves the action of an administrative agency or court, then the report shall set forth the title of the matter, court or agency name, docket number, and dates of occurrence of the reportable event.

(c) Nothing in this section imposes a duty upon any licensee to report to the board the occurrence of any of the events set forth in subsection (a) of this section either by or against any other licensee.

(d) As used in this section, a conviction includes the initial plea, verdict, or finding of guilt, plea of no contest, or pronouncement of sentence by a trial court even though that conviction may not be final or sentence may not be actually imposed until all appeals are exhausted.

(e) Interpretive Comment: A crime of moral turpitude is defined in this chapter as a crime involving grave infringement of the moral sentiment of the community.
Case Study: Practice of Public Accounting; Discreditable Acts, Reportable Events

November 2009

Investigation No.:09-09-19L
Respondent: Clinton Wayne Putman
Hometown: Denison
Certificate No.:086290
Rules Violations:501.80, 501.90(4), 501.91
Act Violations:901.502(6), 901.502(10), 901.502(11)

Respondent entered into an Agreed Consent Order with the Board whereby Respondent’s certificate was revoked in lieu of further disciplinary proceedings. In addition, Respondent was required to pay $213.12 in administrative costs within 30 days of the date the Board ratified the Board Order.

On December 4, 2008, Respondent was convicted of two counts of possession of a controlled substance in a drug-free zone, a third-degree felony offense. Respondent failed to report this conviction within 30 days of the event. Further, Respondent practiced public accountancy with a delinquent, expired license.

Frivolous Complaints

A person who, in writing to the Board, accuses another person of violating the rules of the Board must assist the Board in any investigation and/or prosecution resulting from the written accusation. Failure to do so, such as not appearing to testify at a hearing or to produce requested documents necessary to the investigation or prosecution, without good cause, is a violation of this rule. A person who makes a complaint against another person that is groundless and brought in bad faith, for the purpose of harassment, or for any other improper purpose shall be in violation of this Rule.

Responses to Board Communication

A person shall substantively respond in writing to any communication from the Board requesting a response, within 30 days. The Board may specify a shorter time for response in the communication when circumstances so require. The time to respond shall commence on the date the communication was mailed, delivered to a courier or delivery service, faxed or e-mailed to the last address, facsimile number, or e-mail address furnished to the Board by the applicant or person.

A person shall provide copies of documentation and/or work papers in response to the Board's request at no expense to the Board within 30 days. The Board may specify a shorter time for response in the communication when circumstances so require. The time to respond shall commence on the date the request was mailed, delivered to a courier or delivery service, faxed or e-mailed to the last address, facsimile number or e-mail address furnished to the Board by a person. A person may comply with this subsection by providing the Board with original records for the Board to duplicate. In such a circumstance, upon request the Board will provide an affidavit from the custodian of records documenting custody and control of the records.

Failure to timely respond substantively to written communications, or failure to furnish requested documentation and/or work papers, constitutes conduct indicating lack of fitness to serve the public as a professional accountant.
Each applicant and each person required to be registered with the Board under the Act shall notify the Board, either in writing or through the Board's website, of any and all changes in either such person's mailing address or telephone number and the effective date thereof within 30 days before or after such effective date.

**Mandatory Continuing Professional Education**

Each certificate or registration holder shall comply with the mandatory continuing professional education reporting and the mandatory continuing professional education attendance requirements.

A licensee shall complete at least 120 hours of CPE in each three-year period, and a minimum of 20 hours in each one-year period. CPE, except as provided by board rule shall be offered by board contracted CPE sponsors. The exception to this requirement is an initial licensee, one who has been certified or registered for less than 12 months. A licensee may not claim more than fifty percent of the total CPE credit hours required from the non-technical area in a three year reporting period.

A licensee shall retain documents or other evidence supporting CPE credit hours claimed for the three most recent full reporting periods to the date the credit hours are reported to the board, and shall submit the supporting evidence to the board if such data is specifically requested.

Once an individual's license has been suspended a third time by the board for failing to complete the 120 hours of continuing professional education, the individual's certificate shall be subject to revocation and may not be reinstated for at least 12 months from the date of the revocation.

For additional information on the Texas Board and its enforcement process, see [www.tsbpa.state.tx.us](http://www.tsbpa.state.tx.us). On the home page, scroll down to QUICK LINKS and then click on TEXAS STATE BOARD REPORTS. This newsletter is distributed to all Texas CPAs and contains summaries of the Board’s recent sanctions.

**Four Case Studies: You Decide**

In each of the following fictitious scenarios, please decide which if any of the Texas Rules of Professional Conduct have been violated.

1. Joe Smith, a CPA, was employed at a nonprofit organization, which offered services free of charge to single mothers that needed assistance. The nonprofit received a majority of its funds through grants which were approved by the state of Texas. It was Joe’s job to complete the grant request applications each year and provide the supporting documents necessary to get the grants reapproved. This year was an exceptional year, as the nonprofit had received a very generous donation from one contributor. The problem was that if Joe reported this contribution in the financial statements that he submitted to the state, it was very possible that the state would not reapprove the nonprofit’s grant for next year.

Joe discussed this issue with the board of directors, who then encouraged him to falsify the date that the large contribution was received, to make it appear that it was not received until the following year. Hesitant, but fearful of losing his job, Joe did as the board requested and filed the documents with the state knowing that the financial statements were not reported in accordance with GAAP.

What Rules do you feel that Joe has violated?

In addition to the criminal acts which Joe has committed, Joe has violated the professional standards in the Rules. By fraudulently reporting the date that the contribution was received, he has acted without integrity and also committed discreditable acts under the Rules.
2. Ann Jones, a CPA in public practice, was asked to perform an audit of a public utility company. Although Ann had been a CPA for five years, she just recently opened her practice and had no experience performing audits or working with public utilities companies. Ann was the only employee of her firm and was concerned as to whether she could complete the audit appropriately. On the other hand, she really needed the money and this would be her first big client.

Ann accepted the engagement and decided to lie to the client by telling them that she had performed several audits of this size in the past and had also specialized in public utility companies.

**What Rules do you feel that Ann has violated?**

Ann has violated the Rules of competency by accepting an engagement that she knew she was not experienced enough to perform. In addition she also made false statements to her client regarding her prior experience and qualifications. These actions would violate the Rules for advertising and discreditable acts. Ann was required by the Rules to withdraw from this engagement.

3. Brian Lowes, a CPA and professor at a large university, had become so busy teaching in the past year that he had not had time to complete his continuing education requirements. Although he received his notice from the TSBPA to report his CPE and renew his CPA license, Brian kept putting it off and now his CPA license had expired. The TSBPA had sent him several notices, but those too had gotten piled up on his desk and he had yet to respond to their inquiries.

Brian knew that he could not now practice with a delinquent license, but that would mean having to let the university know of his lapse in judgment and he would most certainly have to resign from his position. Instead, Brian decided to continue to refer to himself as a CPA and keep teaching. He vowed that he would deal with clearing the matter up with the TSBPA as soon as he had some available time.

**What Rules do you feel that Brian has violated?**

Brian has obviously not met the CPE requirements of the Rules. In addition, he has been teaching with a delinquent license and held himself out to be certified, although he was aware that his license had expired. Acting without integrity, committing discreditable acts and not responding to TSBPA inquiries could also be added to the Rules violations which Brian has committed.

4. Becky Lewis, a CPA employed as an internal auditor for a manufacturing plant, is vying for the position of internal audit manager. She has worked for the company for over 10 years and feels she deserves the position. The problem is that one of her co-workers, Sally Cramer, has also been with the company for ten years and feels she deserves the position even more.

Becky is fearful that Sally will be offered the position, because Sally gets along better with the rest of the staff and might be able to manage them better. Becky decides the only way to ensure that Sally will not get the promotion, is if Becky can discredit her in some way. After much thought, Becky decides to modify some of the internal audit reports that Sally had prepared, making it appear that Sally had made fraudulent statements. In addition, Becky decided to write a letter to the TSBPA and claim that Sally had violated the Rules by making false statements and preparing fraudulent reports.

**What Rules do you feel that Becky has violated?**

Besides acting without integrity, Becky has also committed fraudulent and discreditable acts and made a frivolous complaint to the Board.
Chapter Review

(Answers and explanations appear after the Glossary)

1. Which of the following would be defined as a financial statement?
   A. A spreadsheet showing supporting data for a recommendation made to a client
   B. A document supporting a report that is governed by Standards for Attestation Engagements
   C. Notes derived from accounting records intended to convey the current economic state of a business
   D. Supporting schedules for a tax return.

2. Copies of advertising and promotional materials that are sent to prospective clients via electronic, direct mail, or broadcasting must be kept by licensees for at least
   A. 12 months.
   B. 18 months.
   C. 36 months.
   D. 48 months.

3. A licensee convicted of a crime related to his or her duties of a public accountant or certified public accountant who is convicted of a crime related to the performance of such duties must submit a report to the Texas State Board of Public Accountancy
   A. orally to the board within 90 days of the date the licensee has knowledge of the event.
   B. in writing to the board within 60 days of the date the licensee has knowledge of the event.
   C. in writing within 30 days of the date the licensee has knowledge of the event.
   D. orally within 15 days and in writing within 120 days of the date the licensee has knowledge of the event.

4. In the event a certificate or registration holder’s license has been suspended three times for not meeting the mandatory continuing professional education requirements,
   A. the individual’s certificate will be revoked and not reinstated for at least six months.
   B. the individual’s certificate will be revoked and not reinstated for at least twelve months.
   C. the individual’s certificate will be revoked and not reinstated for at least twenty four months.
   D. the individual’s certificate will be revoked permanently.
Glossary (AICPA ET Section 92: Definitions)

Last updated on 3/20/15.

Pursuant to its authority under the bylaws (paragraph .01 [3.6.2.2] of BL section 360, Committees [AICPA, Professional Standards]) to interpret the code, the Professional Ethics Executive Committee has issued the following definitions of terms appearing in the code.

.01 Acceptable level. In connection with independence, an acceptable level is a level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a member’s independence is not impaired. When used in connection with any rule but the “Independence Rule” [1.200.001] an acceptable level is a level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a member’s compliance with the rules is not compromised. [Prior reference: ET section 100-1 and new content]

Effective Date
When this definition is used in connection with any rule but the “Independence Rule” [1.200.001] it is effective December 15, 2014.

.02 Affiliate. The following entities are affiliates of a financial statement attest client:

a. An entity (for example, subsidiary, partnership, or limited liability company [LLC]) that a financial statement attest client can control.

b. An entity in which a financial statement attest client or an entity controlled by the financial statement attest client has a direct financial interest that gives the financial statement attest client significant influence over such entity and that is material to the financial statement attest client.

c. An entity (for example, parent, partnership, or LLC) that controls a financial statement attest client when the financial statement attest client is material to such entity.

d. An entity with a direct financial interest in the financial statement attest client when that entity has significant influence over the financial statement attest client, and the interest in the financial statement attest client is material to such entity.

e. A sister entity of a financial statement attest client if the financial statement attest client and sister entity are each material to the entity that controls both.

f. A trustee that is deemed to control a trust financial statement attest client that is not an investment company.

g. The sponsor of a single employer employee benefit plan financial statement attest client.

h. Any union or participating employer that has significant influence over a multiple or

i. An employee benefit plan sponsored by either a financial statement attest client or an entity controlled by the financial statement attest client. A financial statement attest client that sponsors an employee benefit plan includes, but is not limited to, a union whose members participate in the plan and participating employers of a multiple or multiemployer plan.

j. An investment adviser, a general partner, or a trustee of an investment company financial statement attest client (fund) if the fund is material to the investment adviser, general partner, or trustee that is deemed to have either control or significant influence over the fund. When considering materiality, members should consider investments in, and fees received from, the fund.

[Prior reference: paragraph .20 of ET section 101]

.03 Attest client. A client that engages a member to perform an attest engagement or with respect to which a member performs an attest engagement. [No prior reference: new content]

Effective Date
This definition is effective December 15, 2014.
Attest engagement. An engagement that requires independence, as set forth in the AICPA Statements on Auditing Standards (SASs), Statements on Standards for Accounting and Review Services (SSARSSs), and Statements on Standards for Attestation Engagements (SSAEs). [Prior reference: paragraph .01 of ET section 92]

Attest engagement team. Those individuals participating in the attest engagement, including those who perform concurring and engagement quality reviews. The attest engagement team includes all employees and contractors retained by the firm who participate in the attest engagement, regardless of their functional classification (for example, audit, tax, or management consulting services). The attest engagement team excludes specialists, as discussed in AU-C section 620, Using the Work of an Auditor’s Specialist (AICPA, Professional Standards), and individuals who perform only routine clerical functions, such as word processing and photocopying. [Prior reference: paragraph .02 of ET section 92]

Beneficially owned. Describes a financial interest of which an individual or entity is not the record owner but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or disposition of the interest or to receive the economic benefits of the ownership of the interest. [Prior reference: paragraph .17 of ET section 101]

Client. Any person or entity, other than the member’s employer, that engages a member or member’s firm to perform professional services and, if different, the person or entity with respect to which professional services are performed. For purposes of this definition, the term employer does not include:

a. Person or entity engaged in public practice.

b. Federal, state, and local government or component unit thereof, provided that the member performing professional services with respect to the entity is

i. directly elected by voters of the government or component unit thereof with respect to which professional services are performed;

ii. an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; or

iii. appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body.

[Prior reference: paragraph .03 of ET section 92]

Close relative. A parent, sibling, or nondependent child. [Prior reference: paragraph .04 of ET section 92]

Confidential client information. Any information obtained from the client that is not available to the public. Information that is available to the public includes, but is not limited to, information

a. in a book, periodical, newspaper, or similar publication;

b. in a client document that has been released by the client to the public or that has

c. on publicly accessible websites, databases, online discussion forums, or other electronic media by which members of the public can access the information;

d. released or disclosed by the client or other third parties in media interviews, speeches, testimony in a public forum, presentations made at seminars or trade association meetings, panel discussions, earnings press release calls, investor calls, analyst sessions, investor conference presentations, or a similar public forum;

e. maintained by, or filed with, regulatory or governmental bodies that is available to the public; or

f. obtained from other public sources.

Unless the particular client information is available to the public, such information should be considered confidential client information. Members are advised that federal, state, or local statutes, rules, or regulations concerning confidentiality of client information may be more restrictive than the requirements in the code. [Prior reference: paragraph .05 of ET section 92]
.10 **Control (s) (led).** As used in FASB Accounting Standards Codification (ASC) 810, Consolidation. When used in the “Client Affiliates” interpretation [1.224.010] of the “Independence Rule” [1.200.001], control depends upon the entity in question. For example, when used for not-for-profit entities, control is as used in FASB ASC 958-805-20; for commercial entities, control is as used in FASB ASC 810. [Prior reference: numerous ET sections; also see “Breakdown of the Term Control in the Code” at AICPA.org www.aicpa.org/InterestAreas/ProfessionalEthics/Community/DownloadableDocuments/ breakdown-of-the-term-control.pdf]

.11 **Council.** The AICPA Council. [Prior reference: paragraph .06 of ET section 92]

.12 **Covered member.** All of the following:
   a. an individual on the attest engagement team.
   b. an individual in a position to influence the attest engagement.
   c. a partner, partner equivalent, or manager who provides more than 10 hours of nonattest services to the attest client within any fiscal year. Designation as covered member ends on the later of (i) the date that the firm signs the report on the financial statements for the fiscal year during which those services were provided or (ii) the date he or she no longer expects to provide 10 or more hours of nonattest services to the attest client on a recurring basis.
   d. a partner or partner equivalent in the office in which the lead attest engagement partner or partner equivalent primarily practices in connection with the attest engagement.
   e. the firm, including the firm’s employee benefit plans.
   f. an entity whose operating, financial, or accounting policies can be controlled by any of the individuals or entities described in items a–e or two or more such individuals or entities if they act together. [Prior reference: paragraph .07 of ET section 92]

Effective Date
The addition of partner equivalents to this definition is effective for engagements covering periods beginning on or after December 15, 2014.

.13 **Direct financial interest.** A financial interest that is
   a. owned directly by an individual or entity, including those managed on a discretionary basis by others.
   b. under the control of an individual or entity, including those managed on a discretionary basis by others.
   c. beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary
      i. controls the intermediary or
      ii. has the authority to supervise or participate in the intermediary’s investment decisions.

When used in this definition, the term control includes situations in which the covered member has the ability to exercise such control, either individually or acting together with his or her firm or other partners or professional employees of his or her firm. [Prior reference: paragraph .17 of ET section 101]

.14 **Employing organization.** Any entity that employs the member or engages the member on a contractual or volunteer basis in an executive, a staff, a governance, an advisory, or an administrative capacity to provide professional services. [No prior reference: new content]

Effective Date
This definition is effective December 15, 2014.

.15 **Financial interest.** An ownership interest in an equity or a debt security issued by an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest. [Prior reference: paragraph .17 of ET section 101]

.16 **Financial statement attest client.** An entity whose financial statements are audited, reviewed, or compiled when the member’s compilation report does not disclose a lack of independence. This term is used in the
“Client Affiliates” interpretation [1.224.010] of the “Independence Rule” [1.200.001] and in the definition of an affiliate [0.400.02]. [Prior reference: paragraph .20 of ET section 101]

.17 Financial statements. A presentation of financial data, including accompanying disclosures, if any, intended to communicate an entity’s economic resources or obligations, or both, at a point in time or the changes therein for a period of time, in accordance with the applicable financial reporting framework. Incidental financial data to support recommendations to a client or in (a) documents for which the reporting is governed by SSAEs and (b) tax returns and supporting schedules do not, for this purpose, constitute financial statements. The statement, affidavit, or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion. [Prior reference: paragraph .10 of ET section 92]

.18 Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council and that is engaged in public practice. A firm includes the individual partners thereof, except for purposes of applying the “Independence Rule” [1.200.001] and related interpretations. For purposes of applying the “Independence Rule,” a firm includes a network firm when the engagement is either a financial statement audit or review engagement and the audit or review report is not restricted, as set forth in the AICPA SASs and SSARSs (AICPA, Professional Standards). [Prior reference: paragraph .11 of ET section 92]

.19 Immediate family. A spouse, spousal equivalent, or dependent (regardless of whether the dependent is related). [Prior reference: paragraph .13 of ET section 92]

.20 Impair(ed)(ing). In connection with independence, to effectively extinguish independence. When a member’s independence is impaired, the member is not independent. [Prior reference: paragraph .09 of ET section 100-1]

.21 Independence. Consists of two elements, defined as follows:
   a. Independence of mind is the state of mind that permits a member to perform an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.
   b. Independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party who has knowledge of all relevant information, including the safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or member of the attest engagement team is compromised.

This definition should not be interpreted as an absolute. For example, the phrase “without being affected by influences that compromise professional judgment” is not intended to convey that the member must be free of any and all influences that might compromise objective judgment. Instead, the member should determine whether such influences, if present, create a threat that is not at an acceptable level that a member would not act with integrity and exercise objectivity and professional skepticism in the conduct of a particular engagement or would be perceived as not being able to do so by a reasonable and informed third party with knowledge of all relevant information. [Prior reference: paragraphs .06–.08 of ET section 100-1]

.22 Indirect financial interest. A financial interest beneficially owned through an investment vehicle, an estate, a trust, or another intermediary when the beneficiary neither controls the intermediary nor has the authority to supervise or participate in the intermediary’s investment decisions. When used in this definition, control includes situations in which the covered member has the ability to exercise such control, either individually or acting together with his or her firm or other partners or professional employees of his or her firm. [Prior reference: paragraph .17 of ET section 101]

.23 Individual in a position to influence the attest engagement. One who
   a. evaluates the performance or recommends the compensation of the attest engagement partner;
   b. directly supervises or manages the attest engagement partner, including all successively senior levels above that individual through the firm’s chief executive;
   c. consults with the attest engagement team regarding technical or industry-related issues specific to the attest engagement; or
d. participates in or oversees, at all successively senior levels, quality control activities, including internal monitoring, with respect to the specific attest engagement.

[Prior reference: paragraph .14 of ET section 92]

.24 **Institute.** The AICPA. [Prior reference: paragraph .15 of ET section 92]

.25 **Interpretation.** Pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the rules of conduct. [Prior reference: paragraph .16 of ET section 92]

.26 **Joint closely held investment.** An investment in an entity or a property by the member and client (or the client’s officers or directors or any owner who has the ability to exercise significant influence over the client) that enables them to control the entity or property. [Prior reference: paragraph .17 of ET section 92]

.27 **Key position.** A position in which an individual has

a. primary responsibility for significant accounting functions that support material components of the financial statements;

b. primary responsibility for the preparation of the financial statements; or

c. the ability to exercise influence over the contents of the financial statements, including when the individual is a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

For purposes of attest engagements not involving a client’s financial statements, a key position is one in which an individual is primarily responsible for, or able to influence, the subject matter of the attest engagement, as previously described. [Prior reference: paragraph .18 of ET section 92]

.28 **Lending institution.** An entity that, as part of its normal business operations, makes loans. This definition is not meant to include an organization that might schedule payment for services for a client over a period of time. Examples of such entities are banks, credit unions, certain retailers, and insurance and finance companies. For example, for automobile leases addressed by the “Loans and Leases With Lending Institutions” interpretation [1.260.020] of the “Independence Rule” [1.200.001], an entity is considered a lending institution if it leases automobiles as part of its normal business operations. [Prior reference: paragraph .09 of ET section 92]

**Effective Date**
This revised definition is effective December 15, 2014.

.29 **Loan.** A contractual obligation to pay or right to receive money on demand or on a fixed or determinable date and includes a stated or implied rate of return to the lender. For purposes of this definition, loans include, among other things, a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment. However, for purposes of this definition, a loan would not include debt securities (which are considered a financial interest) or lease arrangements. [Prior reference: paragraph .19 of ET section 92]

**Effective Date**
This revised definition is effective December 15, 2014.

.30 **Manager.** A professional employee of the firm who has continuing responsibility for the planning and supervision of engagements for specified clients. [Prior reference: paragraph .20 of ET section 92]

.31 **Member.** A member, associate member, affiliate member, or international associate of the AICPA. When the term member is used in part 1 of the code, it means a member in public practice; when used in part 2 of the code, it means a member in business; and when used in part 3 of the code, it means all other members. [Prior reference: paragraph .21 of ET section 92]

.32 **Member(s) in business.** A member who is employed or engaged on a contractual or volunteer basis in an executive, staff, governance, advisory, or administrative capacity in such areas as industry, the public sector, education, the not-for-profit sector, and regulatory or professional bodies. This does not include a member engaged in public practice. [Prior reference: paragraph .22 of ET section 92]
Network. For purposes of the “Network and Network Firms” interpretation [1.220.010] of the “Independence Rule” [1.200.001], a network is an association of entities that includes one or more firms that (A) cooperate for the purpose of enhancing the firms’ capabilities to provide professional services and (B) share one or more of the following characteristics:

a. The use of a common brand name, including common initials, as part of the firm name

b. Common control among the firms through ownership, management, or other means

c. Profits or costs, excluding costs of operating the association; costs of developing audit methodologies, manuals, and training courses; and other costs that are immaterial to the firm

d. A common business strategy that involves ongoing collaboration amongst the firms whereby the firms are responsible for implementing the association’s strategy and are held accountable for performance pursuant to that strategy

e. A significant part of professional resources

f. Common quality control policies and procedures that firms are required to implement and that are monitored by the association

A network may comprise a subset of entities within an association only if that subset of entities cooperates and shares one or more of the characteristics set forth in the preceding list. [Prior reference: paragraph .23 of ET section 92]

Network firm. A firm or other entity that belongs to a network. This includes any entity (including another firm) that the network firm, by itself or through one or more of its owners, controls, is controlled by, or is under common control with. [Prior reference: paragraph .24 of ET section 92]

Normal lending procedures, terms, and requirements. In connection with a covered member’s loan from a lending institution, lending procedures, terms, and requirements that are reasonably comparable with those relating to loans of a similar character committed to other borrowers during the period in which the loan to the covered member is committed. Accordingly, in making such comparison and evaluating whether a loan was made under normal lending procedures, terms, and requirements, the covered member should consider all the circumstances under which the loan was granted, including the following:

a. The amount of the loan in relation to the value of the collateral pledged as security and the credit standing of the covered member

b. Repayment terms

c. Interest rate, including points

d. Closing costs

e. General availability of such loans to the public

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such lending institutions. Broker-dealers, for example, are subject to regulation by the SEC. [Prior reference: paragraph .25 of ET section 92]

Office. A reasonably distinct subgroup within a firm, whether constituted by formal organization or informal practice, in which personnel who make up the subgroup generally serve the same group of clients or work on the same categories of matters. Substance should govern the office classification. For example, the expected regular personnel interactions and assigned reporting channels of an individual may well be more important than an individual’s physical location. [Prior reference: paragraph .26 of ET section 92]

Partner. A proprietor, a shareholder, an equity or a nonequity partner, or any individual who assumes the risks and benefits of firm ownership or is otherwise held out by the firm to be the equivalent of any of the aforementioned. [Prior reference: paragraph .27 of ET section 92]

Partner equivalent. A professional employee who is not a partner of the firm but who either

a. has the ultimate responsibility for the conduct of an attest engagement, including the authority to sign
or affix the firm’s name to an attest report or issue, or authorize others to issue, an attest report on behalf of the firm without partner approval; or

b. has the authority to bind the firm to conduct an attest engagement without partner approval. For example, the professional employee has the authority to sign or affix the firm’s name to an attest engagement letter or contract to conduct an attest engagement without partner approval.

Firms may use different titles to refer to professional employees with this authority, although a title is not determinative of a partner equivalent. For purposes of this definition, partner approval does not include any partner approvals that are part of the firm’s normal approval and quality control review procedures applicable to a partner.

This definition is solely for the purpose of applying the “Independence Rule” [1.200.001] and its interpretations and should not be used or relied upon in any other context, including the determination of whether the partner equivalent is an owner of the firm. [Prior reference: paragraph .28 of ET section 92.]

Effective Date
This definition is effective for engagements covering periods beginning on or after December 15, 2014.

.39 Period of the professional engagement. The period begins when a member either signs an initial engagement letter or other agreement to perform attest services or begins to perform an attest engagement for a client, whichever is earlier. The period lasts for the entire duration of the professional relationship, which could cover many periods, and ends with the formal or informal notification, either by the member or client, of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period does not end with the issuance of a report and recommence with the beginning of the following year’s attest engagement. [Prior reference: paragraph .29 of ET section 92]

.40 Professional services. Include all services requiring accountancy or related skills that are performed by a member for a client, an employer, or on a volunteer basis. These services include, but are not limited to accounting, audit and other attest services, tax, bookkeeping, management consulting, financial management, corporate governance, personal financial planning, business valuation, litigation support, educational, and those services for which standards are promulgated by bodies designated by Council. [Prior reference: paragraph .31 of ET section 92]

.41 Public interest entities. All of the following:

  a. All listed entities, including entities that are outside the United States whose shares, stock, or debt are quoted or listed on a recognized stock exchange or marketed under the regulations of a recognized stock exchange or other equivalent body.

  b. Any entity for which an audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to an audit of listed entities (for example, requirements of the SEC, the PCAOB, or other similar regulators or standard setters).

Members may wish to consider whether additional entities should also be treated as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered may include

  • the nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders;
  • size; and
  • number of employees.

Members should refer to the independence regulations of applicable authoritative regulatory bodies when a member performs attest services and is required to be independent of the client under such regulations. [Prior reference: paragraph .20 of ET section 100-1]

.42 Public practice. Consists of the performance of professional services for a client by a member or member’s firm. [Prior reference: paragraph .30 of ET section 92]

.43 Safeguards. Actions or other measures that may eliminate a threat or reduce a threat to an acceptable level. [Prior reference: paragraph .20 of ET section 100-1]
.44 **Share-based compensation arrangements.** As defined in the FASB ASC glossary under the term share-based payment arrangements. [Prior reference: paragraph .02 ET section 101]

.45 **Significant influence.** As defined in FASB ASC 323-10-15. [Prior reference: paragraph .32 ET section 92]

.46 **Source documents.** The documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports that do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders. [Prior reference: footnote 17 in paragraph .05 ET section 101]

.47 **Third-party service provider.** All of the following:

- **a.** An entity that the member does not control, individually or collectively with his or her firm or with members of his or her firm.

- **b.** An individual not employed by the member who assists the member in providing professional services to clients (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions). [Prior reference: paragraphs .224–.225 ET section 191, .023–.024 ET section 291, and .001–.002 ET section 391]

.48 **Those charged with governance.** The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

When an interpretation requires communicating with those charged with governance, the member should determine the appropriate person(s) within the entity's governance structure with whom to communicate, based on the nature and importance of the particular circumstances and matter to be communicated. If the member communicates with a subgroup of those charged with governance (for example, an audit committee or an individual), the member should determine whether communication with all of those charged with governance is also necessary, so that they are adequately informed. [Prior reference: paragraph .33 ET section 92]

**Effective Date**
This definition is effective April 30, 2014.

.49 **Threat(s).** In connection with independence, threats are relationships or circumstances that could impair independence. In connection with any rule but the “Independence Rule” [1.200.001], threats are relationships or circumstances that could compromise a member's compliance with the rules. [Prior reference: paragraph .10 ET section 100-1]

**Effective Date**
When this definition is used in connection with any rule but the “Independence Rule” it is effective December 15, 2014.
Answers and Explanations to Section Review Questions

Part I

1. An accountant who follows a rule even though it might not be in her client’s best interest is probably thinking along the lines of which of the following ethical theories?

   B. Correct. Deontology theory emphasizes the importance of not only the consequences of actions but also the features of the act itself. Deontologists emphasize that morals are based on maxims, rules, and principles, not merely on results. Therefore, the accountant in this question would not, for example, first consider the trade-offs between following a rule and doing what is in the client’s interest (as would be the case according to Utilitarianism), she would place the greatest importance on an established rule in determining what action to take.

   A. Incorrect (Utilitarianism). As described in the above explanation, if the accountant was thinking in terms of Utilitarianism theory, she would be weighing the potential outcomes of her actions as well as any rules that apply in the situation. Deontology theory emphasizes the importance of following the applicable rule or law over the outcome of an action.

   C. Incorrect. Ethics of care is based on the idea that right or wrong actions are based on a person’s motive to exhibit care, to seek moral guidance by developing a model of a good person and the character traits that make up a good person. The focus of this theory is on a person’s inherent goodness as a determining factor in what action he takes when faced with an ethical dilemma.

   D. Incorrect. Principled-based ethics is, theoretically, more consistent with utilitarianism than Deontology in that principles relate to doing what is best in any given situation, as opposed to emphasizing the importance of following rules over the outcomes of actions. It is conceivable for a person to follow a principle that may be in violation of a specific rule because the outcome of a certain action may be more important than the rule that would be violated.

2. The AICPA Code of Professional Conduct states that a CPA should maintain integrity and objectivity. Objectivity in the Code refers to a CPA's ability

   A. Correct (To maintain impartiality). According to the AICPA Principles, "Objectivity is a state of mind, a quality that lends itself to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

   B. Incorrect (To independently distinguish between acceptable and unacceptable accounting practices). The CPA uses judgment and generally accepted accounting principles to evaluate whether a client's accounting practices are acceptable.

   C. Incorrect (To be unyielding in all matters dealing with auditing). The CPA is expected to use professional judgment, which may include flexibility, in applying audit procedures. For example, in unusual circumstances, a CPA might need to
take a position regarding a financial statement that is not entirely consistent with generally accepted accounting principles because of the possibility that the accounting treatment in question will lead to a representation of the financial statements (see interpretation of Rule 203).

D. Incorrect (To independently choose between alternative accounting principles and auditing standards). Auditing standards are concerned with the quality of the auditor's performance, whereas adherence to accounting principles by management is a prerequisite for fairly stated financial statements.

3. In the AICPA Code of Professional Conduct, observing both the form and the spirit of technical and ethical standards relates to the principle of
   B. Correct. Integrity is an element of character. It entails honesty and refraining from the subordination of the public trust to personal gain. Integrity entails the observing of the form and spirit of technical and ethical standards.
   A. Incorrect. Objectivity involves impartiality and being free of conflicts of interest. Whereas integrity is an element of character fundamental to building and sustaining the public’s trust in the profession, objectivity is a state of mind, a quality that lends value to a member’s services.
   C. Incorrect. Independence involves the precluding of relationships that may appear to impair a member’s objectivity. CPAs protect the integrity of their work, maintain objectivity, and, through independence, avoid any subordination of their judgment.
   D. Incorrect. Wisdom has to do with the understanding of what is true, right, and lasting. Wisdom entails having reasoning ability and knowledge of how the world works. It involves emotional intelligence and a reflective understanding of one’s experience. Integrity is enabled, in part, by one’s wisdom, but integrity entails the additional step of “staying the course” with what one knows to be the right course of action.

4. The appearance of independence of a CPA is most likely to be impaired if the CPA
   D. Correct (Serves as executor and trustee of individual owning stock in a client co.).

   independence is impaired if, during the period of the professional engagement, "a covered member was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client. The mere designation as trustee or executor does not impair independence in the foregoing circumstances, but if the CPA was actually serving in that capacity, independence would be impaired.

   A. Incorrect (Appraisal, valuation or actual services). Independence is not necessarily impaired as long as the CPA does not perform management functions or make management decisions (i.e. all significant matters of judgment are determined or approved by the client, and the client is in a position to make an informed judgment.)
B. Incorrect (trade association membership). Independence is not impaired, provided the CPA does not participate in management.

C. Incorrect. A token gift will not impair independence. However, a CPA who accepts more than a token gift, even with the knowledge of the member's firm, will appear to lack independence.

5. A violation of the profession's ethical standards would most likely have occurred when a CPA . . .

C. Correct (Expressed an unqualified opinion on year two when fees for year one were unpaid). The AICPA has ruled that audit fees that are long past due take on the characteristics of a loan under Rule 101. An Ethics Ruling considers independence to be impaired if billed or unbilled fees for client services rendered more than one year prior to the report date remain unpaid when the current year’s report is issued. This amount is viewed as a loan to the client and thus impairs independence (certain loans from financial institution clients are an exception). Thus, independence is impaired and an opinion cannot be expressed if fees for all prior years (year one) are not collected before issuance of the current (year two) report. However, long overdue fees would not preclude the CPA from performing services not requiring independence. The Ruling does not apply if the client is in bankruptcy.

A. Incorrect (Collects notes issued by a client in payment of fees due). The AICPA has ruled that this practice does not violate the Code.

B. Incorrect. (Joins accounting firm with non-CPAs). The Code does not prohibit this arrangement. However, according to the AICPA rule on firm names, such a firm could not designate itself as “Members of the AICPA” unless all CPA-owners are AICPA members.

D. Incorrect (Purchased a bookkeeping firm’s practice). No Code provision prohibits purchase of a bookkeeping firm for a percentage of fees over a given period.

6. In exercising due professional care, an auditor should

A. Correct (Exercise professional skepticism). The AICPA requires auditors to exercise due professional care. Moreover, generally accepted auditing standards require that due professional care be exercised in the planning and performance of the audit and preparation of the report. Exercising due professional care requires professional skepticism.

B. Incorrect (Obtain absolute level of assurance). Sufficient competent evidence should be examined.

C. Incorrect (Design the audit to detect all instances of fraud). The auditor should "plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud."
D. Incorrect. (Base his level of skepticism on the perceived honesty of management).
“The auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest.”

7. A CPA’s retention of client records as a means of enforcing payment of an overdue audit fee is an action that is . . .

C. Correct (Prohibited under AICPA Code . . .). An Interpretation of Rule 501, Acts Discreditable, in the AICPA Code states: "any accounting or other records belonging to the client that were provided to the member by or on behalf of the client. This Interpretation prohibits the retention (after a demand is made for them) of client records to enforce payment or for any other purpose. Such an act is deemed to be discreditable to the profession.

A. Incorrect (Not addressed . . .). The AICPA prohibits retention of client records as a means of enforcing payment of an overdue audit fee.

B. Incorrect (Acceptable if sanctioned by law). In some cases, the requirements of the AICPA Code are more stringent than corresponding legal requirements.

D. Incorrect (A violation of GAAS). Retention of client records as a means of enforcing payment of an overdue audit fee is prohibited by the Code of Professional Conduct, not by GAAS.

8. A violation of the profession's ethical standards most likely would have occurred when a CPA

B. Correct (Received referral fee). The AICPA prohibits a member in public practice from recommending any product or service to a client when the firm performs (1) an audit or review of financial statements, (2) a compilation of a financial statement that is reasonably expected to be used by a third party if the report does not disclose the CPA’s lack of independence, or (3) an examination of prospective financial information for that client.

A. Incorrect (Compiled financial statements of a client that employed CPAs spouse). According to the AICPA interpretation of the Independence Rule, the independence of a member would not be impaired by a spouse's job as a bookkeeper as long as the spouse does not approve transactions, originate data, determine journal entries, etc. Furthermore, a compilation does not require independence.

C. Incorrect (Performed valuation of a client’s business). Independence would not be impaired if all significant matters of judgment are determined or approved by the client, and the client is in a position to have an informed judgment on the results.

D. Incorrect. (Collect notes issued by a client in payment of fees). The AICPA has ruled that arranging with a financial institution to collect notes issued by a client in payment of fees due does not violate the Code.
Part II

1. Which of the following would be defined as a financial statement?

   Rule 501.52. C is correct. (Notes derived from accounting records intended to convey the current economic state of a business). Any data that is presented in accompaniment with accounting records that communicate an entity’s economic resources or obligations at a point in time would be classified as a financial statement.

   A. is incorrect. (A spreadsheet showing supporting data for a recommendation made to a client). Data that are incidental to a recommendation to a client would not constitute financial statements.

   B is incorrect. (Any document supporting a report that is governed by Standards for Attestation Engagements). Documents for which the reporting is governed by Statements on Standards for Attestation Engagements are not financial statements as defined in Rule 501.52.

   D is incorrect. (Supporting schedules for a tax return). Tax returns and supporting schedules are not financial statements as defined in Rule 501.52.

2. Copies of advertising and promotional materials that are sent to prospective clients via electronic, direct mail, or broadcasting must be kept by licensees for at least

   Rule: 501.82. C is correct (36 months). Copies of the actual communication along with a list or other description of parties to whom the communication was distributed must be retained for a period of at least 36 months from the date of its last distribution. This requirement does not apply to anyone when:

   (1) the communication is made to anyone who is at that time a client of the person;  
   (2) the communication is invited by anyone to whom it was made; or  
   (3) the communication is made to anyone seeking to secure the performance of professional services.

   A. (12 months), B. (18 months), and D. (48 months) are incorrect. The retention of the information relating to electronic or direct mail communication must be for a minimum of 36 months.

3. A licensee convicted of a crime related to his or her duties of a public accountant or certified public accountant who is convicted of a crime related to the performance of such duties must submit a report to the Texas State Board of Public Accountancy

   Rule: 501.91. C is correct. (In writing within 30 days of the date the licensee gains knowledge of the event.) A crime committed in the performance of duties related to the qualifications, functions or duties of a public accountant or certificated public accountant must be reported to the board within 30 days of the date the licensee has knowledge of these events.

   A is incorrect. (Orally to the board within 90 days following the event.) The crime must be reported in writing, and within 30 days.
B is incorrect. (In writing to the board within 60 days following the event.) The board must be notified within 30 days, not 60 days, from the date the licensee has knowledge of the event, not when the event occurred.

D is incorrect. (Orally within 15 days of the event and in writing within 120 days of the event.) The report must be in writing and within 30 days from the date the licensee has knowledge of the event.

4. In the event a certificate or registration holder’s license has been suspended three times for not meeting the mandatory continuing professional education requirements,

Rule: 501.94. B is correct. (the individual’s certificate will be revoked and not reinstated for at least twelve months.) Rule 501.94 states: “Once an individual's license has been suspended a third time by the board for failing to complete the 120 hours of continuing professional education required by §523.112 of this title (relating to Mandatory CPE Attendance), the individual's certificate shall be subject to revocation and may not be reinstated for at least 12 months from the date of the revocation.”

A (the individual’s certificate will be revoked and not reinstated for at least six months), C (the individual’s certificate will be revoked and not reinstated for at least twenty-four months), and D (the individual’s certificate will be revoked permanently) are incorrect. The minimum period in which an individual must wait for certificate reinstatement is twelve months, not six or twenty-four months. Also, an individual in these circumstances would have the opportunity to have his or her certificate reinstated, not permanently revoked.
Index

advertising, 43
AICPA, iv, 2, 5, 15, 16, 17, 18, 19, 20, 21, 28, 29, 46
attest engagement, 19, 20, 21, 22, 23, 42
audit, 6, 7, 11, 12, 14, 15, 22, 23, 26, 27, 28, 32, 34, 43, 44
Cheffers and Pakaluk, 4
client confidentiality, 5, 17
client records, 23, 32
Code of Professional Conduct, 5, 15, 17, 18, 19, 20
commissions, 28
competence, 26, 30
confidentiality, 5, 6, 7, 31
conflict of interest, 14, 16, 29
consulting services, 18, 27
contingent fee, 28
covered member, 20
deontology, 4
direct financial interest, 22
due professional care, 30
Enron, 3, 5, 15, 17, 30
ethical issues, 15
family, 8, 9, 12, 13, 14, 18, 23, 39, 40
financial institution, 23, 27
financial statement, 6, 14, 15, 18, 19, 21, 23, 27, 31, 32, 37, 38, 43
independence, iv, 15, 16, 19, 20, 21, 22, 23, 28, 29, 34
integrity, iv, 15, 16, 17, 18, 19, 26, 29, 43, 44
Integrity, 15, 17, 29, 30
key position, 22
manager, 6, 20, 42, 44
nonattest services, 20, 22, 23
objectivity, iv, 15, 16, 17, 18, 19, 29
office, 2, 8, 12, 20, 27, 34
ownership interest, 20
Pacioli, 2
partner, 18, 20, 22, 31, 36
partnership, 36
personal financial planning, 18
principles, 1, 2, 4, 7, 27
professional services, 26, 30, 35
public accounting, 20, 31, 37
Public Company Accounting Oversight Board, 20
public interest, 21, 23
rules, iv, 1, 2, 4, 5, 16, 19, 20, 22, 26, 27, 29, 41
tax return, 6, 15, 31, 32, 33, 37, 38
truth, 1, 2, 11, 12
utilitarianism, 4
WorldCom, 5, 15